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THE CHARTER RENEWAL OF THE EXPORT-IMPORT BANK

HEARINGS

BEFORE THE

SUBCOMMITTEE ON INTERNATIONAL FINANCE, TRADE AND MONETARY POLICY

OF THE

COMMITTEE ON BANKING, FINANCE AND URBAN AFFAIRS HOUSE OF REPRESENTATIVES

NINETY-NINTH CONGRESS

SECOND SESSION

FEBRUARY 5, 20, 25 AND 27, 1986

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CONTENTS

Hearings held on— Page

February 5, 1986 1
February 20, 1986 43
February 25, 1986 97
February 27, 1986 169

WITNESSES

WEDNESDAY, FEBRUARY 5, 1986

Draper, Hon. William H., III, president and chairman, Export-Import Bank of the United States 3
Prepared statement 7

MATERIAL SUBMITTED FOR INCLUSION IN THE RECORD

Draper, Hon. William H., III. response to questions of Representative Sander M. Levin 35
Manton, Hon. Thomas J., opening statement 2

THURSDAY, FEBRUARY 20, 1986

Kjellgren, Bengt, vice president, Citibank, on behalf of the National Foreign Trade Council 44
Prepared statement 47
Nelson, Jim, director, government liaison, United Technologies Corp., on behalf of the Coalition for Employment Through Exports (CEE) 50
Prepared statement 53
Pierce, J.B.L., treasurer, the Boeing Co 64
Prepared statement 69
Smith, Robert J., manager, export sales project financing, General Electric Corp., on behalf of the U.S. Chamber of Commerce 79
Prepared statement 82

TUESDAY, FEBRUARY 25, 1986

Goldhar, Laura, vice president, Chase Manhattan Bank 98
Prepared statement 102
Velden, Axel O., director, Johnson & Johnson export division, on behalf of the Emergency Committee for American Trade [ECAT] 114
Prepared statement 117
Warner, Miner H., vice president, Salomon Bros., Inc 123
Prepared statement 126
Williams, Larry, vice president of marketing, Caterpillar Tractor Co 132
Prepared statement 136

MATERIAL SUBMITTED FOR INCLUSION IN THE RECORD

Export-Import Bank, letter from John A. Bohn, Jr., dated February 24, 1986, concerning revisions in the proposed I-MATCH Program 160
Fertilizer Institute, statement 145

THURSDAY, FEBRUARY 27, 1986

Blum, James L., Assistant Director, Budget Analysis, the Congressional Budget Office; accompanied by Marvin Phaup and Joseph Whitehall 171

Page

Blum, James L., Assistant Director, Budget Analysis, the Congressional Budget Office; accompanied by Marvin Phaup and Joseph Whitehall—Continued
Prepared statement 174

MATERIAL SUBMITTED FOR INCLUSION IN THE RECORD

Blum, James L., response to question of Representative Sander M. Levin 185
Galvin, James J., chairman of the board and chief executive officer, Phosphate Rock Export Association, Tampa, FL, statement with attached exhibits 192

THE CHARTER RENEWAL OF THE EXPORT-IMPORT BANK

WEDNESDAY, FEBRUARY 5, 1986

HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON INTERNATIONAL FINANCE,
TRADE AND MONETAY POLICY,
COMMITTEE ON BANKING, FINANCE AND URBAN AFFAIRS,
Washington, DC.

The subcommittee met, pursuant to call, at 10 a.m., in room 2220, Rayburn House Office Building, Hon. Stephen L. Neal (chairman of the subcommittee) presiding.

Present: Chairman Neal; Representatives Levin, Manton, Leach, Parris, McCollum, and Chandler.

Chairman NEAL. I would like to call the subcommittee to order.

This morning we will be holding our first of four hearings to consider the administration's legislative proposal for the reauthorization of the Export-Import Bank. Our witness today will be William Draper, Chairman of the Export-Import Bank. At our next two hearings, we will receive testimony from exporters of financial institutions.

The administration's proposed legislation includes a revised version of its so-called I-MATCH Program, to replace Exim's existing Direct Lending Program. Last year I opposed the original I-MATCH plan which the subcommittee and committee also rejected. I understand that I-MATCH II is a new creature, and I am sure the committee will approach it as such, that is, with open minds.

I look forward to hearing the testimony of our distinguished witness today in support of the administration's plan. I would like to take this opportunity to wish Bill Draper success in his upcoming work at the United Nations in his position as the Administrator of the U.N. Development Program. We are all saddened to see him leave the Bank, and we know he will be a great asset to the U.N. Development Program, as he has been to Eximbank. Bill, we certainly wish you well, and we will miss you.

At this point in the record, I will place the opening statement of Congressman Thomas J. Manton.

/ Thomas J. Manton

STATEMENT OF CONGRESSMAN THOMAS J. MANTON

SUBCOMMITTEE ON INTERNATIONAL FINANCE, TRADE AND MONETARY POLICY

FEBRUARY 5, 1986

MR. CHAIRMAN, I APPRECIATE YOUR SCHEDULING TODAY'S HEARING ON THE REAUTHORIZATION OF THE EXIMBANK. THIS IS INDEED A TIMELY HEARING GIVEN THE RECENT REPORT OF THE COMMERCE DEPARTMENT THAT OUR NATION'S TRADE DEFICIT IN 1985 WAS A RECORD BREAKING $148.5 BILLION. IN THE MONTHS AHEAD, CONGRESS WILL CONSIDER A NUMBER OF LEGISLATIVE PROPOSALS AIMED AT REDUCING OUR TRADE DEFICIT.

CLEARLY, THE EXIMBANK WILL PLAY A SIGNIFICANT ROLE IN ANY SOLUTION TO OUR TRADE PROBLEMS. TODAY'S HEARING BEGINS THE PROCESS OF DETERMINING EXACTLY WHAT TYPE OF ROLE EXIMBANK WILL PLAY.

LAST YEAR, THIS SUBCOMMITTEE REJECTED THE ADMINISTRATION'S PROPOSAL TO REPLACE EXIMBANK'S DIRECT LENDING PROGRAM WITH AN INTEREST SUBSIDY, OR SO-CALLED "I-MATCH" PROGRAM. I DID NOT SUPPORT THE I-MATCH PROPOSAL LAST YEAR BECAUSE I DID NOT BELIEVE IT WAS PRUDENT TO ELIMINATE EXIMBANKS' DIRECT LENDING PROGRAM IN THE FACE OF A RECORD BREAKING TRADE DEFICIT. SINCE CONGRESS REJECTED THE I-MATCH PROPOSAL, OUR TRADE DEFICIT HAS ONLY GOTTEN WORSE. NEVERTHELESS, I LOOK FORWARD TO HEARING MORE ABOUT THE ADMINISTRATION'S NEW AND IMPROVED I-MATCH II PROPOSAL.

MR. CHAIRMAN, I APPRECIATE YOUR PROVIDING THE MEMEBERS OF THE SUBCOMMITTEE THIS OPPORTUNITY TO HEAR FROM THE ADMINISTRATION TODAY ON THIS VERY IMPORTANT ISSUE.

Chairman NEAL. Are there any other opening statements?

Mr. CHANDLER. No.

Chairman NEAL. If there aren't any other opening statements, then we will proceed. Mr. Draper.

STATEMENT OF HON. WILLIAM H. DRAPER III, PRESIDENT AND CHAIRMAN, EXPORT-IMPORT BANK OF THE UNITED STATES

Mr. DRAPER. Thank you very much, Mr. Chairman.

I should point out that I haven't yet been put into nomination by the Secretary General or, accepted by the General Assembly, but I appreciate being the U.S. nominee and hope I get it and do well. Thank you for those kind words.

Mr. Chairman and members of the subcommittee, I am pleased to appear before you today to ask your support for proposed amendments to the Export-Import Bank Act of 1945, as amended.

We are asking you to extend the life of the Bank for 5 years, through 1991. We are asking for authority to institute an interest matching program to buy down private sector interest rates to OECD minimum rates. I would also like to speak in support of legislation to establish a $300 million mixed credit war chest.

Our first request is that you extend the life to September 30, 1991. This will give the Bank the assurance of continuity and allow us greater flexibility in planning programs and setting policies to support the American exporter.

Since the Bank's charter was last extended, Eximbank has been making improvements in our programs at the rate of one a month. Just last month we increased our long-term financing coverage to 85 percent of the export value—the maximum allowed under the OECD Arrangement rules. On January 15, we dropped our lending rates by 1.05 percent—to correspond to the new minimum levels allowed under the OECD Arrangement.

Let me talk a little bit about these OECD consensus rates and how the international agreements we have negotiated governing these rates have affected our business.

When I came to Eximbank in 1981, we were heavily subsidizing exports by borrowing money at around 15 percent and relending it at 8.75 percent. Our competitors were lending at even lower rates. Eximbank led the way in raising export credit rates to near market levels. Our competitors followed, albeit maintaining their distance, until January 1983, when we dropped our rates to a fully competitive level at that time. In October 1983, we agreed with our OECD counterparts to link export credit rates to market rates and to automatically make adjustments on a periodic basis to reflect changes in market rates.

We have recently conducted a detailed analysis of the disposition of contracts on which Eximbank has offered direct credits. The facts show we are very competitive. Our analysis covers fiscal year 1983 through fiscal year 1985 and the total comes to $15.1 billion. Of this total, preliminary commitments for $4.6 billion were canceled because the project or purchase was dropped or deferred for an indefinite period by the buyer.

Of the $10.5 billion in financing that has gone forward, the United States has won nearly half the business. That is an amazing

statistic considering the high value of the dollar during this period. What is more, nearly half of those U.S. orders were financed from the private sector—often with our financial guarantee—but without any direct lending from Eximbank even though we had offered OECD minimum rate financing. In fiscal year 1985, 80 percent of the total orders won by U.S. suppliers where we had agreed to support the sale with Eximbank credits proceeded with private financing instead. This is the principal reason for the low utilization of our direct credit authority in 1985.

So, in winning agreement to peg export credit rates closely to market rates, we have cut the subsidy element dramatically, and we have accomplished our stated purpose, which is to put the financing of exports more and more into the private sector.

Now what about the orders lost to foreign competition? Well, in every case where the U.S. exporter loses the order, we ask them why they lost. Here is what happened, based on those exporter reports. During the same 3-year period, 93 percent of the losses were due to price or other nonfinancial reasons generally reflecting the high value of the dollar. During 1984 and 1985, none of this business—I repeat, none—was considered by the exporter to be lost because Eximbank was not competitive with OECD-level financing. However, 6 percent of the total losses were due to foreign concessional aid—mostly mixed credits or tied aid. This remains a loophole in the consensus, and we are working to close that loophole—a matter I will address later in my testimony.

We think these figures dramatically demonstrate our competitive strength against subsidized foreign competition. American exporters have cut costs and improved efficiency in the face of a high dollar. Now as the dollar weakens, we are confident that exports will accelerate and our $148.5 billion trade deficit will begin a downward slide.

As I indicated, lending is only one aspect of Eximbank's operations. A far larger propostion of our business is in the area of risk protection—credit insurance and guarantees.

It is particularly in the area of risk taking where Eximbank has led all other nations. We have supported American exporters in country after country where our competition has bowed out. During the international crisis of confidence, we stayed wide open in Mexico, when such nations as Japan, Germany and France stopped doing any business at all and are still cautious. In Brazil, the world's most heavily indebted nation, Eximbank stayed open in all its programs while Japan, Britain and Canada all closed down.

We have been able to take the leadership role in risk assumption during this period, because Eximbank takes the long-term view of the resource-rich debtor nations. We view their problems as those of illiquidity rather than insolvency. And in doing so we have kept trade lines open for U.S. exporters.

In the past 2½ years, we have greatly enhanced our insurance and guarantee programs. Most of the changes we have made are aimed at increasing the use of Eximbank programs by small and medium-sized businesses. Again, in fiscal year 1985, we exceeded our set-aside requirements in support of small business. Congress legislated an 8 percent set-aside for last year. However, 13 percent of Eximbank's total authorizations were devoted to small business,

and over 20 percent of the business we actually did was for small business. Eximbank has a major communication and marketing effort to reach small businessmen around the Nation, and we plan to continue this effort.

Now, I would like to address another significant legislative request. We are seeking a change in language that would enable the Bank to make increased use of private sector financing to support export loans at OECD minimum fixed-rate levels. Under our enhanced I-MATCH II Program, we would obtain private sector financing for fixed-rate export loans at competitive market rates. This money would be lent to foreign buyers at the minimum OECD consensus interest rates where necessary to meet officially supported foreign subsidized competition. When the foreign buyers repay the loans at those consensus interest rates, Eximbank would pay the lending institution any difference between the OECD rate and the competitive market rate. Neither the exporter nor the foreign buyer would be affected by this change. The transaction would appear to them the same as under the present system.

For fiscal year 1987, the President will propose giving Eximbank interest matching authority to support privately funded loans of up to $1.8 billion. That is an increase of around $700 million from the direct lending authority from fiscal year 1986 levels. He will also be requesting a total insurance and guarantee authority of $12 billion, which is the same as our pre-Gramm-Rudman level for this year. This authorization includes up to $1.8 billion in I-MATCH guarantee authority.

The I-MATCH II Program will make a substantial positive contribution to reducing the budget deficit. Under our present Direct Lending Program, we have to use our cash inflow or borrow the money we lend in support of U.S. exports. These loans count as budget outlays, just as if they were payments for salaries, rent, postage or other unrecoverable expenses.

Under the I-MATCH II Program, only the subsidy element in the interest rate on these loans hits the budget. Now, let me tell you how we have improved the interest matching program since it was first proposed for fiscal year 1986.

Our enhanced I-MATCH II Program draws in a much broader section of the financial community to the funding operation.

We listened to the concerns the financial institutions raised last year, and in developing I-MATCH II, we are addressing those concerns. And before putting forth our present program, we invited bankers—those from trade finance and from the capital market side—from small and medium-sized banks in to give us their views. The views have been valuable in helping us develop I-MATCH II. I am confident in stating that we have overcome the misgivings they had about I-MATCH I.

The concerns with I-MATCH I were largely seen to be technical. We improved the assignability feature of our guarantee to make an I-MATCH loan an attractive and marketable instrument. We solved the warehousing problem—eliminating the interest rate risk between the funding of a loan and the actual disbursements. We have provided for a one-time drawdown from the lender.

In our medium-term program, we are not requiring banks to take a fixed rate risk over the life of the loan. We are adjusting the in-

terest rate makeup every 6 months in line with market rates for 6-month funds. That is the medium-term program.

In addition to working closely with bankers, we have sought the advice of a wide range of exporters and incorporated their suggestions, as well. I think we have demonstrated to their satisfaction that I-MATCH II is technically sound.

Finally, I would like to ask your continued support for another piece of pending legislation: the establishment of a $300 million war chest in the Treasury Department for purposes of assisting negotiations for much greater restrictions on the use of tied aid credits to support commercial export sales. When testifying before your committee last fall, I explained how this war chest would be able to finance over $1 billion of U.S. exports, because the funds would be blended with standard Eximbank export credits in a ratio of one part grant to three or four parts standard export credits. The President intends to request appropriations for this fund for fiscal year 1987, and we are grateful for the support this legislation has already received from this subcommittee as we consider congressional backing essential for our negotiating position.

As you know, the U.S. Government has been pressing our OECD counterparts to raise the level of the minimum grant element in tied aid credits from 25 percent to 50 percent. At the President's direction, we have already begun an aggressive campaign of targeted mixed credit action where we feel it will have the maximum impact on negotiations. It is directed against those countries that have been impeding those negotiations. Since adoption of our more aggressive policy last autumn, we have made eight offers of mixed credits. That is, we have offered to combine one of our normal export credits with either a low-interest long-term loan from our own resources or else a grant from the war chest when that money becomes available. We maintain the option to go either way.

In some cases, we surprised our competition by making mixed credit offers in the traditional markets of these countries—where they have previously not found it necessary to offer concessionary financing. Or on cases where they have outstanding mixed credit offers, we made even more concessionary offers in support of American exporters.

Two weeks ago I was in Paris at negotiations with other OECD countries. The meeting was productive by clearly pointing out that most of the 22 countries support increased curbs on mixed credits. For example, the Japanese arrived taking the position that there should be an immediate and significant increase in the minimum grant level. Almost every other country outside the Common Market took a similar position. I hope—and, incidentally, I understand that the majority of the countries inside the Common Market have a similar position as well—that these encouraging signs point to a satisfactory agreement this spring, but they may not.

Until we have that agreement signed, sealed and delivered, we need to keep the pressure up, which means we need favorable action on the war chest legislation from you.

Thank you very much. I would be pleased to answer any questions that you or the other members of the committee may have.

[The prepared statement of Mr. Draper with attachments follow:]

Statement by
William H. Draper III
President and Chairman
Export-Import Bank of the United States
Before The
Subcommittee On International Finance, Trade and Monetary Policy
Committee on Banking, Housing and Urban Affairs
United States House of Representatives

February 5, 1986

Mr. Chairman, Members of the Committee, I am pleased to appear before you today to ask your support for proposed amendments to the Export-Import Bank Act of 1945, as amended.

We are asking you to extend the life of the Bank for five years, through FY 1991. We are asking for authority to institute an interest matching program to buy down private sector interest rates to OECD minimum rates. I would also like to speak in support of legislation to establish a $300 million mixed credit war chest.

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This will give the Bank the assurance of continuity and allow us greater flexibility in planning programs and setting policies to support the American exporter.

Since the Bank's charter was last extended, Eximbank has been making improvements in our programs at the rate of one a month. Just last month we increased our long-term financing coverage to 85% of the export value--the maximum allowed under OECD Arrangement rules. On January 15th we dropped our lending rates by 1.05%--to correspond to the new minimum levels allowed under the OECD Arrangement.

Let me talk a little bit about these OECD consensus rates, and how the international agreements we have negotiated governing these rates have affected our business.

When I came to Eximbank in 1981, we were heavily subsidizing exports by borrowing money at around 15 percent and re-lending it at 8-3/4 percent. Our competitors were lending at even lower rates. Eximbank led the way in raising export credit rates to near market levels. Our competitors followed, albeit maintaining their distance, until January 1983, when we dropped our rates to a fully competitive level. In October 1983 we agreed with our OECD counterparts to link export credit rates to market rates, and to automatically make adjustments on a periodic basis to reflect changes in market rates.

We have recently conducted a detailed analysis of the disposition of contracts on which Eximbank has offered direct credits. The facts show we are very competitive. Our analysis covers Fiscal Year 1983 through Fiscal 1985 and the total comes to $15.1 billion. Of this total, preliminary commitments for $4.6 billion were cancelled because the project or purchase was dropped or deferred for an indefinite period by the buyer.

Of the $10.5 billion in financing that has gone forward, the U.S. has won nearly half the business. That's an amazing statistic considering the high value of the dollar during this period. What is more, nearly half of those U.S. orders were financed from the private sector -- often with our financial guarantee -- but without any direct

lending from Eximbank even though we had offered OECD minimum rate financing. In FY1985, 60% of the total orders won by U.S. suppliers where we had agreed to support the sale with Eximbank credits, proceeded with private financing instead. This is the principal reason for the low utilization of our direct credit authority in FY1985.

So, in winning agreement to peg export credit rates closely to market rates, we have cut the subsidy element dramatically . . . and we have accomplished our stated purpose, which is to put the financing of exports more and more into the private sector.

Now what about the orders lost to foreign competition? Well, in every case where the U.S. exporter loses the order, we ask them why they lost. Here's what happened, based on those exporter reports. During the same three-year period, 93% of the losses were due to price or other non-financial reasons . . . generally reflecting the high value of the dollar. During FY1984 and FY1985 none of this business . . . I repeat, none, was considered by the exporter to be lost because Eximbank was not competitive with OECD-level financing. However, six percent of the total losses were due to foreign concessional aid . . . mostly mixed credits or tied aid. This remains a loophole in the consensus and we are working to close that loophole . . . a matter I will address later in my testimony.

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As I have indicated, lending is only one aspect of Eximbank's operations. A far larger proportion of our business is in the area of risk protection -- credit insurance and guarantees.

It is particularly in the area of risk taking where Eximbank has led all other nations. We have supported American exporters in country after country where our competition has bowed out. During the international crisis of confidence we stayed wide open in Mexico, when such nations as Japan, Germany and France stopped doing any business at all, and are still cautious. In Brazil, the world's most heavily indebted nation, Eximbank stayed open in all its programs while Japan, Britain and Canada all closed down.

We have been able to take the leadership role in risk assumption during this period, because Eximbank takes the long-term view of the resource-rich debtor nations. We view their problems as those of illiquidity rather than insolvency. And in doing so we have kept trade lines open for U.S. exporters.

In the past 2½ years we have greatly enhanced our insurance and guarantee programs. Just last month we announced a vastly enhanced Multibuyer Policy for Exporters. We and our agent, FCIA, worked closely with a group of some 15 exporters, large and small, and representing many different industries to come up with this policy. It offers more options to exporters, such as flexibility in deductibles and the availability of uniform coverage against both political and commercial risks of non-payment on export receivables. It extends the time for reporting shipments. It reduces the requirements for reporting overdue payments. It reduces the waiting period for filing claims. In addition, to encourage use by smaller exporters with limited shipments, the new policy features a greatly reduced minimum annual premium---from $2,000 to $500. This policy features what the exporting community asked for.

Another major improvement announced this month was the extension of delegated authority to commit the Eximbank guarantee to working capital loans of up to $300,000. We took this program nationwide, after trying it out in our four-state test marketing program. This should enable us to offer pre-export help to many, many more small firms around America.

Like the extension of the working capital guarantee and the lowering of the minimum annual premium on our multibuyer policy, most of the changes we have made are aimed at increasing the use of Eximbank programs by small and medium-sized businesses. Again in FY85 we exceeded our set-aside requirements in support of small business. Congress legislated an 8% set aside for last year. However 13% of

Eximbank's total authorizations were devoted to small business and over 20% of the business we actually did was for small business. Eximbank has a major communication and marketing effort to reach small businessmen around the nation. And we plan to continue this effort.

This brings me to the first of two "housekeeping" changes in our legislation that we are requesting. We are asking for a clarification of the Bank's authority to charge reasonable fees for work or services performed and use these fees to offset costs and for other expenses. Mainly we intend to charge nominal user fees for such things as conferences, seminars and publications, which can be used to cover the costs of holding or producing them. This would enable us to have the users share at least part of the costs involved in our communications efforts, something that is increasingly imperative as we seek to reduce expenditures, and therefore the budget deficit.

We would also like to make a change in the language concerning the terms of directors. We want to keep the staggered four year terms, but allow any director whose term has expired to continue to serve until his or her successor has been qualified. This simply enables the Bank to keep operating smoothly in cases where appointments or reappointments are caught up in administrative or legislative delays. Without the change we are requesting the Bank could overnight find itself in a situation in which it had an insufficient number of directors to continue to take board action.

Now I would like to address another significant legislative request.

We are seeking a change in language that would enable the Bank to make increased use of private sector financing to support export loans at OECD minimum fixed-rate levels. Under our enhanced I-MATCH-II program, we would obtain private sector financing for fixed-rate export loans at competitive market rates. This money would be lent to foreign buyers at the minimum OECD consensus interest rates where necessary to meet officially supported foreign subsidized competition. When the foreign buyers repay the loans at those consensus interest rates, Eximbank would pay the lending institution any difference between the OECD rate and the competitive market rate. Neither the exporter nor the foreign buyer would be affected by this change. The transaction would appear to them the same as under the present system.

For Fiscal Year 1987 the President will propose giving Eximbank interest matching authority to support privately funded loans of up to $1.8 billion. That's an increase of around $700 million from the direct lending authority from FY86 levels. He will also be requesting a total insurance and guarantee authority of $12 billion, which is the same as our pre-Gramm-Rudman level for this year. This authorization includes up to $1.8 billion in I-MATCH guarantee authority.

The I-MATCH II program will make a substantial positive contribution to reducing the budget deficit. Under our present direct lending program we have to use our cash inflow or borrow the money we

lend in support of U.S. exports. These loans count as budget outlays just as if they were payments for salaries, rent, postage or other unrecoverable expenses.

Under our enhanced I-MATCH II program we can tap a broad section of the financial community to fund these loans themselves with our guarantee. We will put the funding for long-term loans out for competitive bidding. In the medium-term program we will make up any difference between the lenders' cost of money (based on a widely-used benchmark rate, such as the reserve adjusted, six month large deposit CD rate) plus 100 basis points and the OECD minimum fixed-rate on the note.

Under the I-MATCH II program only the subsidy element in the interest rate on these loans hits the budget.

Now, let me tell how we have improved the interest matching program since it was first proposed for FY1986.

Our enhanced I-MATCH II program draws in a much broader section of the financial community to the funding operation.

We listened to the concerns the financial institutions raised last year, and in developing I-MATCH II we are addressing those concerns. And before putting forth our present program we invited bankers--those from trade finance and from the capital market side - from small and medium-sized banks in to give us their views. The views have been valuable in helping us develop I-MATCH II. I am confident in stating we have overcome the misgivings they had about I-MATCH I.

The concerns with I-MATCH I were largely seen to be technical. We improved the assignability feature of our guarantee to make an I-MATCH loan an attractive and marketable instrument. We solved the warehousing problem--eliminating the interest rate risk between the funding of a loan and the actual disbursements. We have provided for a one time drawdown from the lender.

In our medium-term program we are not requiring banks to take a fixed rate risk over the life of the loan. We are adjusting the interest rate make-up every six months in line with market rates for six month funds.

In addition to working closely with bankers we have sought the advice of a wide range of exporters and incorporated their suggestions, too. I think we have demonstrated to their satisfaction that I-MATCH II is technically sound.

Finally I would like to ask your continued support for another piece of pending legislation: the establishment of a $300 million war chest in the Treasury Department for purposes of assisting negotiations for much greater restrictions on the use of tied-aid credits to support commercial export sales. When testifying before your Committee last fall I explained how this war chest would be able to finance over $1 billion of U.S. exports, because the funds would be blended with standard Eximbank export credits in a ratio of one part grant to three or four parts standard export credits. The President intends to request appropriations for this fund for FY1987, and we are grateful for the support this legislation has already received from this subcommittee as we consider Congressional backing essential for our negotiating position.

As you know, the Treasury Department and Eximbank have been pressing our OECD counterparts to raise the level of the minimum grant element in tied-aid credits from 25% to 50%. At the President's direction we have already begun an aggressive campaign of targeted mixed credit action where we feel it will have the maximum impact on negotiations. It is directed against those countries that have been impeding those negotiations. Since adoption of our more aggressive policy last autumn, we have made eight offers of mixed credits. That is, we have offered to combine one of our normal export credits with either a low-interest long term loan from our own resources or else a grant from the war chest when that money becomes available. In some cases we surprised our competition by making mixed credit offers in the traditional markets of these countries--where they have previously not found it necessary to offer concessionary financing. Or on cases where they have outstanding mixed credit offers, we made even more concessionary offers in support of American exporters.

Two weeks ago I was in Paris at negotiations with other OECD countries. The meeting was productive by clearly pointing out that most of the 22 coutries support increased curbs on mixed credits. For example, the Japanese arrived taking the position that there should be an immediate and significant increase in the minimum grant level. Almost every other country outside the Common Market took a similar position. I hope that these encouraging signs points to a satisfactory agreement this spring, but they may not.

Until we have that agreement signed, sealed and delivered we need to keep the pressure up, which means we need favorable action on the war chest legislation.

Thank you very much. I would be pleased to answer any questions you may have.

Dear Mr. Speaker:

I have the honor of submitting herewith a draft of legislation, "To amend the Export-Import Bank Act of 1945, as amended."

The proposed legislation would amend three sections of the Export-Import Bank Act of 1945, as amended (12 U.S.C. §635 et seq.), namely, Section 2(a)(1), Section 3(c)(8) and Section 8. In particular, this legislation would clarify Eximbank's authority where necessary to subsidize export loans provided by other lenders. This legislation would also clarify Eximbank's authority to defray the costs of Eximbank-sponsored conferences and seminars or Eximbank publications by charging reasonable fees for these services. In addition, in order to prevent any interruption in the operation of the Eximbank Board of Directors, the bill would make clear that a director of Eximbank may continue to serve after the expiration of his or her term until his or her successor has been appointed. Finally, the proposed legislation would extend the life of Eximbank from September 30, 1986 to September 30, 1991.

The Office of Management and Budget has advised that enactment of this legislation would be in accord with the program of the President.

Sincerely,

William H. Draper III

Enclosures

The Speaker of the House of
Representatives
The Speaker's Room
U.S. House of Representatives
Washington, D.C. 20515

99th CONGRESS
1st Session

S. _____

H.R. _____

, 1986

A BILL

To amend the Export-Import Bank
Act of 1945, as amended

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

SEC. 101. That Section 2(a)(1) of the Export-Import Bank Act of 1945, as amended (12 U.S.C. §635(a)) is amended by inserting after "to guarantee, insure, coinsure, and reinsure against political and credit risks of loss;" the following: "to provide a sufficient return to commercial lending institutions or other lenders making loans in support of exports of goods and services when financing at other than market rates is necessary to respond to subsidized financing offered by foreign export credit agencies;".

SEC. 102. That Section 2(a)(1) of such Act (12 U.S.C. §635(a)) is further amended by inserting after the fifth sentence thereof the following new sentence: "The Bank may charge such fees as the Bank may determine to be reasonable for work or services performed or provided or to

be performed or provided in connection with or in furtherance of the Bank's objects and purposes (including but not limited to conferences, seminars, documents and reports or other publications); such fees shall be available until expended and may be used to pay directly the costs of such work or services or other Bank expenses and to repay or make advances to funds which do or will initially bear all or part of such costs or expenses."

SEC. 103. That Section 3(c)(8) of such Act (12 U.S.C. §635a(c)(8)) is amended by adding at the end thereof the following subparagraph: "(E) Any director whose term has expired may serve until his or her successor has been appointed.".

SEC. 104. That Section 8 of such Act (12 U.S.C. §635f) is amended by striking out "September 30, 1986" and inserting in lieu thereof "September 30, 1991".

SECTION-BY-SECTION ANALYSIS

Section 101 amends Section 2(a)(1) of the Export-Import Bank Act of 1945, as amended, (12 U.S.C. §635(a)) to make it clear that where financing at other than market rates is necessary to respond to subsidized financing offered by foreign export credit agencies Eximbank possesses the authority to assure a sufficient rate of return to commercial lending institutions and other lenders making export-related loans. In this way, the lenders would be able to provide loans at rates which are necessary for U.S. suppliers to compete with foreign suppliers receiving support from their official export credit agencies, while at the same time the lenders could be assured of receiving a sufficient rate of return. The determination as to what constitutes market rates as well as what constitutes a sufficient return would be left to the judgment of the Eximbank Board of Directors. The Board of Directors would also use its judgment in determining the existence and nature of the officially subsidized export financing.

Section 102 further amends Section 2(a)(1) of the Export-Import Bank Act of 1945, as amended (12 U.S.C. §635(a)) to clarify Eximbank's authority to defray the costs of Eximbank-sponsored activities. During recent years, Eximbank has been engaged in extensive marketing efforts to

inform and counsel U.S. businesses and banks about its export assistance programs. These efforts have involved Eximbank-sponsored seminars and conferences as well as various publications describing its programs and activities. This amendment would make clear Eximbank's authority to offset the costs of conferences and seminars as well as publication expenses and other activities through reasonable fees. Any excess funds would be available to cover other expenses of the Bank.

Section 103 is intended to assure the availability at all times of a quorum of members of the Eximbank Board of Directors by amending Section 3(c)(8) of the Export-Import Bank of Act of 1945, as amended, to make it clear that a director may continue to serve after the expiration of his or her term until his or her successor has been appointed. In this way, there would be no interruption in the operation of Eximbank in general.

Section 104 amends Section 8 of the Export-Import Bank Act of 1945, as amended, to extend the life of the Bank from September 30, 1986 to September 30, 1991.

DISCUSSION DRAFT
2/3/86

EXPORT IMPORT BANK OF THE UNITED STATES

OUTLINE OF REVISED EXIMBANK I-MATCH PROGRAMS

LONG-TERM I-MATCH PROGRAM

This program replaces Eximbank's existing Direct Lending Program. Its purpose is to meet foreign subsidized competition. It will provide fixed rate funding at OECD rates and terms to support U.S. exports of heavy capital equipment, large-scale installations and project-related services which are usually financed over a term of five years or longer and which have an export value of over $10 million.

A. Lending Procedures

The replacement of the Direct Lending Program by the Long-Term I-Match Program should have virtually no impact upon the U.S. exporter or the foreign buyer. Preliminary commitments will be issued under the Long-Term I-Match Program in the same way that preliminary commitments have been issued under the Direct Lending Program. Eximbank will enter into an agreement with the foreign purchaser under which Eximbank will undertake to arrange for financing for the purchase of U.S. goods and services by the foreign purchaser. This agreement will adhere closely to the credit agreements that Eximbank has entered into previously under the Direct Lending Program. The foreign purchaser will issue to the private institutional lender promissory notes virtually identical to the promissory notes that were issued previously to Eximbank under the Direct Lending Program. The principal and interest of these notes will be fully guaranteed by Eximbank.

Under the Long-Term I-Match Program, the funds will be provided by a private institutional lender which will receive an unconditional guarantee of repayment from Eximbank against all political and commercial risks as well as an interest rate make-up provision to assure a rate agreed upon between that lender and Eximbank on the basis of a competitive bidding procedure.

Procedures for the Long-Term I-Match Program are set forth in more detail below:

Lending Procedures

1. Applications to Eximbank for a preliminary commitment (PC) for fixed rate financing for a transaction may be

made by the overseas buyer, U.S. exporter or a U.S. or foreign bank involved in the transaction. If the U.S. supplier wins the export sale, the prospective borrower must submit a final loan application to Eximbank within 180 days from the date of issuance of the PC. PC's may be extended upon application to Eximbank.

2. Upon approval of the loan application, Eximbank will enter into an agreement with the borrower (and guarantor, if any).

a. The agreement will contain an undertaking on the part of Eximbank to make fixed rate financing available from a private institutional lender at Arrangement rates, and in the amount and over the term agreed upon.

b. The borrower will pay Eximbank a credit application fee of 2% and a commitment fee of 0.5% per annum on the undisbursed balance of the financing. These are the same fees that are charged under the Direct Lending Program.

c. Eximbank will arrange for disbursements to be made to the borrower under Eximbank's regular disbursement procedures.

d. All payments of fees and interest and repayment of principal installments will be made by the borrower to Eximbank.

e. During the disbursement period the borrower may cancel any unused portion of the loan without incurring a penalty. The borrower will also be permitted to make prepayments at any time without penalty.

f. As under the Direct Lending Program, the borrower will be required to make arrangements to pay any withholding taxes that may be levied on interest payments.

g. The borrower will issue promissory notes in favor of such private institutional lenders as Eximbank may specify. Such promissory notes will be transmitted to Eximbank which will add its unconditional guarantee as to political and commercial risks and its agreement as to the rate of interest (as specified in paragraph B(2) below) to the promissory notes and deliver them to the private institutional lender selected to fund the transaction.

3. Application may be made to Eximbank in the event that the foreign buyer should require additional funding for a transaction.

B. Guarantee and Funding Procedures

Eximbank will enter into Master Guarantee and Funding Agreements with all private institutional lenders interested in participating in the Long-Term I-Match Program.

The Master Guarantee and Funding Agreement will contain the following provisions:

1. Eximbank's unconditional guarantee of repayment against all commercial and political risks associated with any transaction for which the private institutional lender will provide financing. This guarantee will commit the full faith and credit of the U.S. Government.

2. Eximbank's interest rate make-up provision to the effect that the private institutional lender will receive interest at the winning bid rate for such transaction (see paragraph 4 below) regardless of the rate of interest that may be paid by the borrower under the agreement. This provision, when coupled with the guarantee in paragraph 1, will also assure the private institutional lender of receiving the full amount of principal and interest at the winning bid rate, even if the borrower fails to make payment of any amount of principal or interest for which it is liable. This provision will also commit the full faith and credit guarantee of the U.S. Government.

3. Eximbank's undertaking that the private institutional lender will not have to pay any withholding taxes or other taxes that may be levied by the country in which the borrower is located. Conversely, the private institutional lender will not be allowed to derive any benefit from the tax receipts from any withholding tax or other tax that may be levied.

4. Bidding and funding procedures:

a. After a final loan application has been approved in connection with a particular transaction and shortly before the initial disbursement, Eximbank will invite each private institutional lender which has entered into a Master Guarantee and Funding Agreement to submit a bid containing the fixed rate of interest at which it will be willing to make a loan.

b. Eximbank will specify the amount of the loan to be provided by the private institutional lender, the date when the loan will be deposited in an account to be administered by Eximbank, and the dates on which the loan will be repaid.

c. Bids will be submitted to Eximbank in the form set forth in an attachment to the Master Guarantee and Funding Agreement.

d. The private institutional lender with the lowest bid will be awarded the financing, and Eximbank will enter into a letter agreement in the form of another attachment to the Master Guarantee and Funding Agreement with the winning private institutional lender which will make the agreement applicable to that transaction.

e. The funds will be drawn down from the private institutional lender in one lump sum shortly after the winning bid is selected. At that time the private institutional lender will be provided with a promissory note previously issued by the borrower and to which Eximbank has added its own full faith and credit guarantee.

f. Funds from the private institutional lender will be deposited in a special account administered by Eximbank. The private institutional lender will receive interest at the winning bid rate. As the borrower requests disbursements, Eximbank will draw down from the account.

g. As disbursements are made by Eximbank to the borrower, the borrower will pay to Eximbank interest for the account of the private institutional lender at the Arrangement rate from the dates of disbursement and Eximbank will make additional payments to the private institutional lender equal to the difference between the Arrangement rate and the winning bid rate (or whatever amount is necessary to ensure that the lender always receives the full amount of interest at the winning bid rate). If the Arrangement rate is higher than the winning bid rate, Eximbank will retain the difference.

h. Eximbank will charge the private institutional lender a guarantee fee of 0.5% per annum on the outstanding amount of the loan. Such fee will be included in the amount to be paid by Eximbank under paragraph g so that the private institutional lender will always receive interest at the bid rate.

i. A promissory note together with Eximbank's guarantee may be transferred if a private institutional lender wishes to make use of either of the following financing mechanisms --

I. A one-time transfer to a trust, which may then issue freely-transferable participation certificates in the trust. These participation certificates will not be

guaranteed by Eximbank. No further transfer of the guarantee will be permitted without Eximbank's approval. However, there will be no limit on the number of certificate purchasers and no minimum certificate amount. Certificates may not be issued in bearer form.

or

II. On each loan transaction, a transfer to a limited number of investors, each of which may further transfer the guarantee without Eximbank's approval, provided that each transfer is made to a single investor and the full amount of the transferor's share is transferred. Transferees may retransfer their shares subject to the same conditions. The number of investors to which a transfer may be made ultimately will depend upon the amount of the funding.

5. Cancellation of a commitment or prepayment by the borrower will not result in a prepayment to the private institutional lender without the lender's consent. Instead, Eximbank will invest the funds until needed for normal repayments to the private institutional lender.

6. The private institutional lender will not be permitted to impose any fees directly upon the borrower in connection with the funding for the transaction.

MEDIUM-TERM I-MATCH PROGRAM

This program will provide fixed rate funding to support U.S. exports which are usually financed over a term of longer than one year but not more than five years and with an export value of less than $10 million. It will replace the existing Medium-Term Credit Program and Small Business Credit Program. Transactions that would have been handled under the latter program will still not require proof of competition; otherwise, proof of competition will be required as is the practice under the current Medium-Term Credit Program.

Under the Medium-Term I-Match Program, a bank may select (a) an unconditional guarantee of repayment by Eximbank against all political and commercial risks as well as an interest rate make-up provision as set forth in paragraph B(3) below or (b) only the interest rate make-up provision. The I-Match guarantee is available only in combination with the interest make-up provision. The existing Medium Term

Bank Guarantee Program is available where only a guarantee is needed.

A. Lending Procedures

1. All banks which are eligible under existing medium-term programs will be permitted to participate in the Medium-Term I-Match Program.

2. Application for a preliminary commitment (PC) for medium-term financing may be made by a bank which has entered into a Master Guarantee and Funding Agreement as specified below. If the U.S. supplier wins the export sale, the bank must submit a final application to Eximbank within 180 days from the issuance of the PC, unless the PC is extended by Eximbank. Until the PC is converted to a final authorization there is no charge to the bank or exporter.

3. In accordance with the usual procedures applicable to medium-term programs, the bank and borrower may enter into a credit agreement. The borrower will also issue a promissory note in the form specified by Eximbank. The note will require the borrower to pay interest at the Arrangement rate applicable to such transaction.

4. In any transaction for which the bank has requested Eximbank's guarantee, the promissory note will be sent prior to disbursement to Eximbank which will add its guarantee in the same way as will be done under the Long-Term I-Match Program. The note will then be delivered to the bank.

B. Guarantee and Funding Procedures

Eximbank will enter into a Master Guarantee and Funding Agreement with any eligible bank interested in participating in the Medium-Term I-Match Program.

The Master Guarantee and Funding Agreement will contain the following provisions:

1. Eximbank's interest rate make-up provision to the effect that the bank will receive interest at the rate specified in paragraph 3 below regardless of the rate of interest that may be paid by the borrower under the credit agreement. This provision will also commit the full faith and credit of the U.S. Government.

2. Eximbank's unconditional guarantee of repayment of all commercial and political risks associated with any transaction for which the bank will provide financing and has requested Eximbank's guarantee. This guarantee will commit

the full faith and credit of the U.S. Government. If the interest make-up provision is provided with the guarantee under this paragraph, the bank can be certain of receiving the full amount of principal and interest at the rate specified in paragraph 3 below, even if the borrower fails to make payment of any amount of principal or interest for which it is liable.

3. Eximbank will pay to the bank on the interest due dates (which will be standardized under the program so that they fall on two of four dates throughout the year) an amount equal to the difference between the promissory note rate and a benchmark rate, the reserve adjusted Large Deposit 6-Month Certificate of Deposit rate (CD Rate) plus 100 basis points. The CD Rate will be taken from the Wall Street Journal and will be set on each interest due date to apply to interest accruing for the succeeding six-month period. If the Arrangement rate is greater than the CD rate plus 100 basis points, the private lender will pay the difference to Eximbank on the interest due dates.

4. Once the bank has committed itself to a transaction, it will not be permitted to cancel the interest rate make-up provision, simply because the Arrangement rate may become greater than the CD rate plus 100 basis points.

5. The loan may be sold without recourse to another party, provided that the original bank continues to service the loan. However, Eximbank will not continue interest make-up payments after the loan is sold. No further transfer of Eximbank's guarantee may be made without Eximbank's consent. In addition, the loan may be sold at any time at par to PEFCO without recourse, provided that the original bank continues to service the loan. It should be noted that PEFCO will purchase only those notes that carry an Eximbank guarantee of all political and commercial risks. In transactions involving multiple disbursements, the bank may not sell the loan until final disbursement.

6. If the bank requests only the interest rate make-up provision, the bank will pay the same commitment fee presently charged under Eximbank's Medium-Term and Small Business Credit Programs. If the bank requests both the interest rate make-up provision and the guarantee under paragraph 2, the bank will pay a front-end fee which is no greater than the amount it would have paid under Eximbank's existing Medium-Term Guarantee and Credit Programs. A bank participating in this program will be free to negotiate any other fees it customarily charges.

Chairman NEAL. Thank you, Mr. Draper.

I still have some of the same questions I had about the original I-MATCH Program. In your testimony, you presented a very positive view of accomplishments of Eximbank over the last several years, and I certainly commend you for the progress you have made, and agree with much of what you have said. But that leads to this question: We have got a successful program, why change it? That is one general question.

The other is: On page 7, you say that the I-MATCH II Program will make a substantial positive contribution to reducing the budget deficit. Well, as near as we can tell this approach to lending costs more money. I think you finally came to agreement with us on that. I think all the committee Members came to agree that that was the case. We don't know precisely how much more, but at least $20 million, $30 million a year more to accomplish the same purpose, and it is hard for me to see how spending $30 million more a year helps reduce the budget deficit.

Now, I know that because of delay, due to the way accounting for Eximbank is done, that some reduction in the deficit could show on paper. But I think you and I both know that that is smoke-in-mirrors and not a real, in any sense, reduction of the budget deficit.

So let me just start, if I can, with those two questions. If we have got a program that works, why change it with something that we really don't know will work or not; and also we need to address this budget deficit question.

Mr. DRAPER. We currently have a program that works, but the pressures on you, the Congress, to reduce the budget deficit in the coming years is so strong that I am very concerned that the entire effort to block foreign government intervention in the marketplace will be sacrificed. That is the reason for the change. We want to get direct credits where they belong.

We have now a Direct Credit Program where the Treasury is lending us the money, and we are lending it directly out on a long-term basis. Instead of the foreign customers of our exporters would borrow from the private sector, with our guarantee that those private institutions that are lending the money will get repaid, which is a much more effective, efficient system overall. And so we think that while it is working and has worked currently under a direct credit scheme, we are very concerned about the budget requirements and the pressures on you that this whole program may be sacrificed.

Chairman NEAL. Excuse me one second. When you say it is more effective and efficient, where is the evidence for that?

Mr. DRAPER. Well, we will have the lowest possible cost loans from the private sector.

Now, we will get into that a little bit in a minute. I can't deny that the Treasury might have a more efficient system overall of directly borrowing, but the efficiency is lining up our guarantee with the private sector so that you, the Congress, know what is really happening at the Eximbank—the only aspect of our operation that will be damaging to the budget will be either losses through claims that we are not able to recover or, two, the general cost of our subsidies.

Chairman NEAL. Isn't that true now?

Mr. DRAPER. No, because the effect on the budget today is, that direct credit impacts the budget substantially.

Let me read you some numbers that show that, because that was the second part of your question. If we have a direct credit program, the net outlays are a surplus of $810 million in 1987 and a surplus of $871 million in 1988. This is under $1.8 billion of credits per year for the next 5 years. We would have direct credit outlays of a negative $810, $871, $911, $958, and $778 million respectively.

That is the negative impact; in other words, we would have more money coming in and less going out under the I-MATCH Program. Those surplus numbers under I-MATCH would read $955 million for 1987 and $1.406 billion for 1988, in other words a positive impact on the budget in 1989 of $1.739 billion; and in 1990, $1.861 billion; and in 1991, $1.689 billion. So they are a substantially larger, more favorable impact on the budget. The reduction to the budget deficit would total over the 5 years $3.322 billion.

Chairman NEAL. You mean on paper, not in the real world?

Mr. DRAPER. It is the way you keep the books.

Chairman NEAL. I know—it is not the way I keep the books. We can argue about the books, but I am trying to separate the real world from the bookkeeping world. The real world is what I am interested in at this point, which is real financial savings to the Federal Government, and any way you look at it in dollars and cents, the I-MATCH Program costs $20 or $30 million a year more in dollars. We can fool around with the bookkeeping——

Mr. DRAPER. $40 million is based on $1.8 billion. It may be as low as $20 million, but that is the efficiency that you are talking about in the Treasury borrowing more efficiently than the private sector——

Chairman NEAL. At a lower rate.

Mr. DRAPER. Slightly lower rates. Very slightly lower. I mean, it is $20 million vis-a-vis operations that are affecting billions of dollars of commitments. I think you should know——

Chairman NEAL. I am trying to focus on the $20 or $30 million. I think it is significant, and if it costs more, I have to have——

Mr. DRAPER. Your smoke and mirrors argument, though, Mr. Chairman, is if we took the whole thing off the budget. But we are not suggesting that we take the whole thing off the budget. The subsidy would still remain on the budget, and that is the thing you ought to be keeping your eye on. I am concerned about that in the Appropriations Committee, for example, where last year they cut us back from $1.8 billion requested to $1.1 billion in a tight squeeze, because everybody was concerned about the Gramm-Rudman effects in the future and the needs of cutting the budget deficit.

So I think it is really an important element to understand how much the Eximbank really costs the government rather than concentrating on these very large numbers that have nothing to do but affect cash flow. I mean, it is a very smoke and mirrors game if you start to talk about our cost on the Government being $1.8 billion. That is not true.

Chairman NEAL. Of course, it is not.

Mr. DRAPER. We are making loans of, let's say, $1.8 billion. We will get them back with interest, interest rates currently, because

of the OECD negotiations, have now come down—our costs have now come down to a point they are below the amount we charge, so that we are actually making money on our direct loans today.

Chairman NEAL. Good. I see no reason why we shouldn't.

Mr. DRAPER. We will continue to make them under the I-MATCH Program too.

Chairman NEAL. If we were to run our economy sensibly, our fiscal policy sensibly, we would make loans, interest rates would be down. And many years in the past the Eximbank has made money. I would hope that would be the case.

I am really trying to just focus in on this one point, and I take seriously your point that the focus ought to be on the level of subsidy and that that is where the real cost comes, whether it is the direct lending program or the I-MATCH Program, it doesn't make any difference. The real cost is the subsidy element. The subsidizing in I-MATCH costs more money. There is no question about that.

Mr. DRAPER. We will have a positive impact on the budget this year, you realize that.

Chairman NEAL. No, you will have a bookkeeping impact on the budget. The budget deficit will not be reduced by one dollar as the effect of changing it. The bookkeeping will be changed. You can do the same thing by putting a lot of things off, you could put welfare off budget——

Mr. DRAPER. The real cost of welfare versus the real cost of Eximbank is exactly what I am talking about. That is a very different thing than putting the real cost of Eximbank on the budget. That is what we really want to do. What we want to remain is the difference between our rate charge and the interest makeup that we give to those that are funding it. This is just a funding transfer; it is purely a funding transfer from the U.S. Government to the private sector. It has the benefit of really telling you, the Congress, what is going on with regard to the numbers, because you and I both agree that there is a lot of smoke and mirrors about the Federal budget and the ways in which the books are kept.

I am trying to clear that up and make it a clearer picture with regard to Eximbank. So maybe it might cost you $20 million, but might save you billions of dollars over the years in order to clearly identify what is happening, and we are not an expensive agency to operate——

Chairman NEAL. If we ask you about the subsidy levels and so on, isn't that in your annual report? That is no huge mystery right now, is it, for anyone who wants to know?

Mr. DRAPER. Somebody is cutting back the size of our direct credit based on the fact you can't afford it on the budget, so we are going from $1.8 billion now to $1.1 billion this year, and that is suffering, and that doesn't make sense for the American exporter in a time when they ought to have consistent understanding of where they will stand over the next 5 years. They are very worried about it, and so are we at the Eximbank.

Chairman NEAL. I don't think it is any mystery of who that someone is who is cutting it down.

Mr. DRAPER. Yes. It is the Congress. The administration asked for $1.8 billion, and we are going to get $1.1 billion.

Chairman NEAL. We will see. I don't know. The other argument, the question is whether we are going to have an I-MATCH or nothing, and that might be an argument for I-MATCH. I will keep an open mind about it, but still there is the risk. We have got a program that works. We will be going to a program that may or may not work, we don't know yet. Other countries use it, and it is going to cost us more money for the benefit of some bookkeeping entries. That may be the decision. It might be worth it.

Mr. McCollum.

Mr. MCCOLLUM. I, first of all, want to say, Dr. Draper, we very much appreciate your services. I understand you are about to move on, and I think the report you gave us today is reflective of what most of us have realized all along, that is that you have run a very good, positive ship over there, and we are going to miss you.

Mr. DRAPER. Thank you.

Mr. MCCOLLUM. The second thing I would like to say, I do, as I did before, support the I-MATCH Program, and I am glad to see you have improved it from the standpoint of the practicality which was bothering me a good deal, and I know it bothered industry, and apparently now you have presented us with an I-MATCH Program, the only question of which is not whether it will work, but the question of the $20 million efficiency in the bookkeeping entry.

It is my impression that under the new I-MATCH Program you are offering now, actually while there may be a greater expense in efficiency that is involved, that actually you are going to continue to make money on these loans and that we are really talking, if you are trying to talk about nets, some reduction in the net income if you want to look at it that way. There are a lot of ways you can look at this. You can look at it the way Chairman Neal is looking at it or the way the budgetmakers and accountants are looking at it, or the net to the Eximbank. Is that correct?

Mr. DRAPER. Yes. I have to clear up a misconception, though. We are not making money now. We made loans back in the 1970's at rates that were, in order to be competitive, very, very out of line with our costs, so we are strung out with commitments that will last for many years still where we borrowed the money at, let's say, 15 percent and loaned it at 8 percent. Currently we are not doing that. We are lending it at a rate above our costs on all categories of countries. Even at the poorest country rate, 8.8 percent, we can borrow today on a 7-year loan if we had to at probably below 8.7 percent or so. In the richer countries, we do make money.

But I want to point out that the economic benefit or loss to the taxpayer will be identical, whether it is under the I-MATCH or the direct credit. I don't think we are saying there would be any difference to the taxpayer. What I want is a system that works and is not pushed around by a bad accounting method, where we are judged by our cash flow rather than by our——

Mr. MCCOLLUM. The bottom line is, if we all had our wishes, the most efficient way to go would be to change the accounting method altogether and keep the direct loans. It doesn't appear we are going to change that, Congress isn't going to do that in this budget, the administration isn't going to do that at OMB.

So what you are asking is reasonable. You are saying it is a wash, you can argue whether it is going to be $20 million, or what-

ever, efficiency. But at the end, if you count what your various loans—I realize you have lower interest loans out there, but at any given time, you can consider this to be a wash, and that is what you are saying. It is again a matter of perspective.

I don't have a lot of questions to ask you, because I think you answered what I had in mind of asking. I yield back to the chairman and wish you luck in what you do next.

Mr. DRAPER. Thank you very much.

Chairman NEAL. Mr. Levin.

Mr. LEVIN. Just a couple questions. First, congratulations.

Mr. DRAPER. Thank you, sir.

Mr. LEVIN. We will miss you. We are glad the agency survived.

Mr. DRAPER. So am I.

Mr. LEVIN. You are going to be following in some distinguished footsteps.

Mr. DRAPER. That is right.

Mr. LEVIN. The administration participated in the making of a good choice.

Mr. DRAPER. Thank you very much.

Mr. LEVIN. A few questions.

First of all, your testimony about the reduction in the direct loan authority, I think we all chuckle a bit when you say Congress cut it——

Mr. DRAPER. Yes, I did, too.

Mr. LEVIN. I didn't quite catch the dynamics of the last few years, but be that as it may, I think it opens up the question, if it is being reduced to $1.1 billion, or whatever, why not do both? Why not institute I-MATCH, combine it with some continued direct loan authority and see how I-MATCH works?

Mr. DRAPER. Sure. I call it sort of a belt and suspenders kind of approach, because I think that it is a reasonable question to ask. The exporters have asked the same thing. Frankly, we are so confident that this system will work, we would just like to terminate the direct credit system entirely and go to this more flexible, more visible program that has a lot of benefits.

It increases some of the commercial bankers' attention to export financing. There are more likely to be bankers who will be interested in the program; perhaps they will reach out to some of their potential exporters and get them to export because they are able to work with our programs and make money on it in the medium term, especially the small and medium-size accounts. I think you could maintain the direct credit only if you, in your heart, just didn't feel this was technically feasible. Otherwise it really is not needed, and we should go ahead and switch, I think, from one train to the other train and make it a clean break. But, you know, the question is certainly reasonable.

Mr. LEVIN. Well, it is likely if it weren't for the savings, which in a way is a paper savings, you might advocate—I think everybody is better off if they acknowledge the realities that drive decisions. We tend to dance around, if we were there and you were here, you would probably ask the questions we are asking. We would give maybe the same answers. I hope not. I mean, you can say a clean break, and there is reason to do that, you have full confidence and all that, but if it weren't for this terrible bind, you wouldn't prob-

ably object to having both for a year or two, right? It might be the more prudent way to proceed. I don't think there is anything wrong in your answering yes to that.

Mr. DRAPER. I know, but my concern on the "yes" answer is that I am really up here proposing that we go full-blown behind I-MATCH as a system for operating. It solves some problems with lots and lots of people: the exporter, who is concerned about his future and whether or not he is going to have sufficient direct credit capability to block foreign under-market intervention; the Congressman who is concerned about the budget deficit; the administration conservatives who are concerned about loans from the U.S. Government of any type. This is not just a problem with Eximbank, but they are trying to cut loans of all types. It just keeps the whole exporter-oriented program at the Eximbank alive and well and not subject to the whims of a last-minute negotiation where we are competing against loans to foreign aid or other world organizations.

It just makes it more palatable all-around and more realistic. It honestly brings more realism into the situation, which is something you mentioned. Because we now are able to focus on how much this is costing us, and it is very small, and we are able to concentrate on the important things. When you mix it all up together under big authorizations of $1.8 billion, it seems like that is the amount that we are spending. Well, we are not spending that, as all of us in the room know, but that is the perception; and certainly at appropriations time, the planning for cash flow has to affect our budget, and it shouldn't affect our budget, because we can't predict whether we will be able to fund some new major power projects, aircraft, space satellites. We don't know what is going to come up.

A lot of small business growth may occur, although that is more predictable. But things in the future are very hard to predict. Well, if you have to constantly worry about your budget when you are setting our authorization level, you are really damaging the clarity with which an exporter can look to the future.

Mr. LEVIN. Let me ask you, then. I wanted to ask you a series of questions about small businesses. Let me just ask a couple and then tie it quickly back into this issue we have been discussing.

A couple of us just held a conference on auto parts and exporting them. I think to the surprise of a lot of people, a lot of firms showed up. There were over 100 firms and a lot of smaller firms, which I think gives credence to this subcommittee's interest in your efforts. Maybe you want to submit this for the record, I know you can't have all these details right at your fingertips, but what is the balance? You say here it is now 13——

Mr. DRAPER. Percent?

Mr. LEVIN. Thirteen percent. How does that compare with 5 years ago? How much progress are we making?

Mr. DRAPER. That is a good question, and I don't have the facts before me.

Mr. LEVIN. Maybe you can let us know. It would be interesting to see the trend lines.

Mr. DRAPER. Absolutely.

[In response to the request of Congressman Levin, the following information was submitted for the record by Mr. Draper:]

It was 13 percent of the total available, but 22.3 percent of what we actually authorized was for small business.

For 1984, the comparable figures are 13 percent and 20.9 percent. Our records were not maintained in a comparable way prior to that, but we know that more use is being made of these programs.

Mr. LEVIN. Also, if you could let us know how much of Exim Direct Loan authority is now consumed by, say, the 15 largest entities. I ask that question not because I want to go out after the big ones. I think our airline manufacturers should be able to compete with foreign manufacturers—in fact, we complained because Exim, or whoever it was, wasn't active enough, and some years ago we lost business strictly over the interest rate. I think that is acknowledged.

I ask that mainly, anyway, to look at how smaller medium-size businesses are doing. Would you be able to guess what the top 15 are taking out of the pot? Would it be 50 percent? It used to be very large, right? The top 10 took maybe——

Mr. DRAPER. I have here for you the top 20 in 1984—direct credit only, which is what you asked—the top 20, including companies that you may never have heard of, like Unit Rig Co. and Giant Corp.——

Mr. LEVIN. That is a big company, I understand——

Mr. DRAPER. They vary quite a bit—like Bell Helicopter, General Electric, and so on—but included Otis Engineering National Supply and Hewlitt-Packard. The top 20 got 80 percent of direct credits authorized. But they do a lot of the exporting in the country. I don't know how you could compare them.

Mr. LEVIN. The problem really is to get middle and small business into exporting.

Mr. DRAPER. We already know, I think, that small business has moved up dramatically from where it was earlier, eating into that other 20 percent of direct credit. But you realize a big part of our business, the biggest part, is in the guarantee and the insurance side, where the small companies are getting familiar with exporting and they need the absorbing of the risk by us, and that is something that we have done. Out of a budget of $10 billion, for guarantees and insurance, $1.8 billion was used for small business. That is a pretty good lump.

Mr. LEVIN. Would you do this, if you could get us the latest details, also with the definitions you are now using in all of these areas.

Mr. DRAPER. I would be happy to.

[In response to the request of Congressman Levin, the following information was submitted for the record by Mr. Draper:]

EXPORT-IMPORT BANK OF THE UNITED STATES

*Small Business Authorizations
Compared to Total Authorizations
FY 1986 thru December 31, 1985
($ Millions)

	Total Auth.		Small Business		
	Amount	No. Trans.	Amount	No. of Trans.	Percent Amount Small Business
Regular Loans	$ 83.9	5	$ 4.9	3	5.8%
Medium Term Credits	118.9	62	2.5	1	2.1
Small Business Credits	7.4	11	7.4	11	100.0
Total Loans	$ 210.2	78	$ 14.8	15	7.0
Financial Guarantees	45.9	7	10.9	7	23.7
Bank Guarantees	158.3	51	42.2	7	26.7
FCIA Insurance	971.0	219	215.1	151	22.2
Total Guarantees & Insurance	$1,175.2	277	$ 268.2	165	22.8
Grand Total	$1,385.4	355	$ 283.0	180	20.4%

*Eximbank uses the definition of small business as defined in the Small Business Act.

Mr. LEVIN. Risk insurance, the guarantees, because I would think--you state here that—just to finish my questions—that the exporters, your language is a little cautious, you say "I think we have demonstrated to their satisfaction that I-MATCH," we use wonderful language around here. We have never acted on I-MATCH I. But I-MATCH II was technically sound, and then you say as to financial institutions, "I am confident in stating we have overcome the misgivings they had about I-MATCH I."

Mr. DRAPER. But I don't want to speak for the exporters. They have to speak for themselves, I think.

Mr. LEVIN. Do they support I-MATCH II?

Mr. DRAPER. I think the majority whom I have talked to do. I don't know any who haven't agreed that it is technically sound.

Mr. LEVIN. Financial institutions and exporters?

Mr. DRAPER. Yes.

Mr. LEVIN. Let me ask, then, maybe you would like to comment at greater length in writing, what likely impact the change to I-MATCH would be on small and medium exporters. I see the financial institutions having a high level of interest in larger companies, in these larger interest subsidization situations, but you take small and medium-size companies, whom we must encourage to get into this, you know, we have talked about how entrepreneurship, how 80 percent or 75 percent of the new jobs are coming from small business—right—but a small percentage of exporting increase is coming from that, and I think there is a mismatch, and it would be interesting for you to give us some further testimony in writing whether you think there is more risk here in terms of the transfer to I-MATCH for the smaller and medium-size companies than there is for the larger.

As you know, I haven't been intrinsically opposed to I-MATCH, I was rather attracted to it on an experimental pilot project basis and phasing it in. I am restless, though, I think you need to really show that a complete break with the past is not only good for budgeting purposes, and I am interested in that, too, because I am looking, like everybody else, for the easier pickings because there aren't very many, there are very few.

But does it really make sense in terms of the promotion of exporting in this country, especially among the medium and smaller entities? I would hope you could give us some kind of concept paper that probes this issue at some length.

Mr. DRAPER. I would point out that we have analyzed that, and we think it would be a neutral effect on all businesses, and that is the difference between I-MATCH I and I-MATCH II, by the way, Mr. Levin. The difference is that we were not able to get the small and medium-size banks to be happy with our previous proposal because we didn't have a floating rate system. Now we do for them so that we will guarantee them that they will have a 1 percent return if they do this business, which is what they have now under the medium-term program. Before they had to speculate on what interest rates would be over the next 3, 4 or 5 years. Five years is up to the medium term limit.

Mr. LEVIN. Could you give us, if I may interject and then turn it over to Mr. Leach, isn't the issue of small banks versus big banks?

Mr. DRAPER. That often means small business.

Mr. LEVIN. But not always.

Mr. DRAPER. Not always, I agree.

Mr. LEVIN. Most of these firms, a lot of them, are in larger industrial areas, and they have to deal with the big—in Michigan, it isn't the small firm that will go to a Frakenmuth bank or the medium-size firm, it is the small firm that has to deal with the National Bank of Detroit or Empire of America or large entities, and the questions—under I-MATCH II, are they going to be interested?

Mr. DRAPER. I think they really are. It won't be different for them. They still deal with their normal bank, whether it is a big bank or small bank, and that bank is the one we train. We have, you know, and we make it just as easy for that small business to do business with us, because he does business with his bank, and he doesn't have to concern himself on the medium term or on the long term; he still deals with the Eximbank, the same as he always did.

We have tried to make this absolutely neutral in relation to whether it is a direct credit system or an I-MATCH system. It is just the funding mechanism, and we take responsibility for the funding. The reason I mentioned the small and medium-size banks is that they were willing to take the risk on the fixed interest, rather.

Chairman NEAL. Mr. Leach.

Mr. LEACH. I also would like to welcome you on what I understand will be your last testimony before the subcommittee. I think the record will show the President's effort to preserve the institution. I think we have laid the basis for long-term growth.

I think the record will also indicate, because of the high interest rate structure, that you began work at what might have been a troubled financial institution in terms of the sudden showing of losses, but you are ending as one of the world's most successful bankers, showing a profit. That is good for all of us.

The minority has been more sympathetic to I-MATCH from the beginning than the majority, probably because of what appears to be the clear implications of congressional budget restraint. I think it is a "have your cake and eat it too" philosophy, and it is very promising. It probably is, however, more costly.

On the other hand, it is a serious recognition within the administration, that it should take it off budget. But given the fact that Congress didn't take it off budget, I think I-MATCH is very responsible and is going to be a real plus for the export community, and I would say a particular plus as the value of the dollar is sinking rather than rising.

We all recognize that under the rising dollar scenario, you never met your full potential and obligations because there wasn't enough demand. In an era of the falling dollar, it could be that that demand will increase substantially. And if it does, the I-MATCH approach has a great deal more flexibility than maintenance of direct lending, which comes under the budgetary purview of this subcommittee.

Now, maybe that problem or opportunity will never be presented, but if it is, that could be the strongest single argument for I-MATCH, although certainly a convincing argument could be made simply because of the constraints of Gramm-Rudman.

I think for all of the concerns of the export community, it implies a little bit of uncertainty. It is an uncertainty that produces greater certainty. A far greater uncertainty would be to wait for Exim to be treated the same way as all other budgetary approaches where we don't know where the ax is going to fall.

So ironically the greatest weakness of the I-MATCH approach, which was its uncertainty, has now become its greatest strength. For that reason, I think that your leadership in developing this approach is perhaps more important than anything else you have done at Eximbank, and your successor will be handed over an institution that will be, I think, very important in the days and years to come.

With that, I have no questions, Mr. Chairman.

Mr. DRAPER. Thank you very much.

Chairman NEAL. On that point, it is my understanding that Gramm-Rudman would have the same impact on this program as it would on the Direct Lending Program as far as accounting and the same impact on the guarantee program.

In other words, it would be an across-the-board requirement for cut if we get into that second stage of Gramm-Rudman where the sequestration process takes effect.

Mr. LEACH. Gramm-Rudman applies to on-budget items in a very different way than it does to off-budget items.

Chairman NEAL. Does it? I don't know about that.

Mr. LEACH. I must say we are as uncertain as some of you are.

Chairman NEAL. I am not sure. I am just saying that was my initial reading of that. Just as a matter of interest, I may have told you this before, but when I first became chairman of this subcommittee some years ago I had some other reason to be in Europe and I was interested in how they handled their export program and visited their facilities and talked to their folks and they do it, as you know, very much like you are proposing now that we do it.

I was very excited by the idea. It made a lot of sense to me. I said it is much more realistic, so on. Came back, Steve DeBruhl, a Republican, was Chairman of the Eximbank at that time, and I discussed the idea with him and he convinced me at the time it was a lot more expensive way to do it. So we sort of dropped that idea for a while.

But anyway, we are going to keep an open mind about it. Did you say you are going to be funding some space program?

Mr. DRAPER. No. There was a man who said that, but we do telecommunications systems. We do the space satellite. We finance a lot of those literally.

Chairman NEAL. What is going to happen if some of the so-called conservatives are successful in getting Savimbi to blow up the oil facilities over there in Angola? I understand Exim has some exposure there.

Mr. DRAPER. Right. We do have some exposure there. We made those loans because we are prevented by law from discriminating against countries where we have a reasonable assurance of repayment, unless we are specifically prohibited by an act of Congress or by a determination by the Secretary of State, acting for the President, that it is not in our national interest to do business in those countries.

The financial situation in those loans involved guarantees by Gulf Oil and the Government of Angola and a payment facility outside the country, also of which made them financially sound, and we therefore had no choice but to make the loans when they were requested. I don't think we have done any new direct credits for 18 months—that I can remember anyway.

Chairman NEAL. Mr. Manton, welcome.

Mr. MANTON. Mr. Chairman, thank you.

Chairman NEAL. Let me recognize you at this time.

Mr. MANTON. Mr. Draper, I am sorry, that I was not here for your remarks. However, I did read your testimony which mentioned your support for legislation to establish a $300 million mixed credit war chest.

Mr. DRAPER. Yes, sir.

Mr. MANTON. How does that reconcile with the administration's proposal to terminate the direct lending approach?

Mr. DRAPER. Well, they are two quite different things, but, you are right, there is a relationship in the way in which we actually might end up handling the funding of those mixed credits. We are awaiting congressional action on the $300 million mixed credit fund in hopes that we will ultimately get funded for this.

If we do, then we have written into our mixed credit proposals that we can either fund them privately with our guarantee, no change in interest rate or term or anything that would affect the exporter or his customer, or we would have the right to switch from our current straight, direct loan to the mixed credit fund if it exists and is funded. We have done eight of these mixed credits up to this point just on our own in trying to bring some sense into the bargaining.

Mr. MANTON. Could you describe those eight cases?

Mr. DRAPER. There were two in Brazil that had to do with hospital equipment, involved a lot of exporters, and there was one in India for computer telecommunication equipment. In Algeria, there is a large underground subway system that is being proposed and we made a large mixed credit offer for Algeria.

Now, that was a little different because mixed credits are not used by the French in Algeria, which, of course, is a Francophile country. We are trying to get into their territory just like they are trying to get into our territory, which might be considered Latin America where they have come in quite aggressively. So we have initiated some of these mixed credits.

Another one was navigation equipment in Tunisia and, again, another navigation equipment proposal in Brazil. In India there is a turbine generator, and I think the most recent one we did was for nine Earth satellite stations in Gabon. We made a mixed credit proposal there.

Mr. MANTON. Would that make the difference on whether we got the business or not?

Mr. DRAPER. We won't know that. We have one piece of business down in Brazil, one of those hospitals in Sao Paulo, but we won't know about the others for a while. Some 18 months ago or so we did one in Indonesia that was a prerunner to this aggressive program targeted only at the French, and we did that for a profiler for

an aircraft plant they were building there. The profiler was built by Cincinnati Milicron, and they did get that business.

Time has to run. For example, the Algerian subway case may not be known for years because there are typical delays on large projects like that. Perhaps the Gabon one will come in sooner because it is a product, an Earth satellite station.

Mr. MANTON. Thank you.

Mr. DRAPER. You are welcome.

Chairman NEAL. Thank you, sir.

Bill, thank you so very much for coming and we will be hearing from the exporters and representatives of financial institutions soon and we will try to come up with something sensible.

Mr. DRAPER. Thank you very much, Mr. Chairman. I have enjoyed appearing before you and I know your whole subcommittee is very aggressive on exports and we do appreciate that at the Eximbank, and I will miss you all.

Chairman NEAL. We will miss you, too. Thank you.

[Whereupon, at 11:10 a.m. the subcommittee adjourned, subject to the call of the Chair.]

THE CHARTER RENEWAL OF THE EXPORT-IMPORT BANK

THURSDAY, FEBRUARY 20, 1986

HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON INTERNATIONAL FINANCE,
TRADE AND MONETARY POLICY,
COMMITTEE ON BANKING, FINANCE AND URBAN AFFAIRS,
Washington, DC.

The subcommittee met at 10:03 a.m., in room 2220 of the Rayburn House Office Building, Hon. Stephen L. Neal (chairman of the subcommittee), presiding.

Present: Chairman Neal; Representatives Leach, Parris, McCollum, and Chandler.

Chairman NEAL. I would like to call the subcommittee to order at this time.

This morning, we begin our second day of hearings on the administration's legislative proposals for the reauthorization of the Export-Import Bank and the establishment of its so-called I-MATCH Program. Our panel this morning consists of Bengt Kjellgren, vice president, Citibank, on behalf of the National Foreign Trade Council; Jim Nelson, director, government liaison, United Technologies Corp., on behalf of the Coalition for Employment Through Exports; J.B.L. Pierce, treasurer of the Boeing Co.; and Robert J. Smith, manager, export sales project financing, General Electric Corp., on behalf of the U.S. Chamber of Commerce.

The subcommittee has asked these witnesses to assess the merits of I-MATCH from their points of view as representatives of exporting companies or financial institutions that finance exports. And we also want to hear any other recommendations they might have in the way of amendments to improve the Export-Import Bank Act.

Before we proceed with this testimony, I would like to call the attention of members to a pending development which could have a major impact on our consideration of I-MATCH.

The Congressional Budget Office will soon issue its estimates of the President's proposed budget. I have been informed that CBO's estimates of I-MATCH's budgetary impact will differ sharply from those of the Office of Management and Budget.

The purpose of I-MATCH has always been to take the Bank's Direct Loan Program "off-budget." Last year, I was against I-MATCH, in part because I regarded it as a budgetary gimmick, a shift in bookkeeping to show a spurious reduction in the budget deficit.

This reduction, I argued, would be spurious because it would have no real impact on the economy or on the credit markets. Nonetheless, I assumed, as did everyone, that a shift from direct loans to I-MATCH would at least yield a bookkeeping decline in the deficit.

Now it appears that even this bookkeeping reduction could disappear. I understand that CBO intends to score I-MATCH, should we authorize it, the same as it scores direct loans. That is, CBO would estimate that I-MATCH would require the same budget authority and give rise to the same outlays as an equivalent amount of direct loans.

In fact, BA and outlays for I-MATCH would even be somewhat higher than for direct loans, since the real cost of I-MATCH would be somewhat higher than the real cost of direct loans.

If this interpretation of I-MATCH's budgetary impact is accepted by the Budget Committee, the primary appeal of I-MATCH would vanish overnight. It would be pointless for us to authorize I-MATCH and for the Appropriations Committee to set guarantee ceilings for I-MATCH as requested by the administration if the Budget Committee, following CBO's interpretation, then score I-MATCH against the budget resolution, just as it would have scored an equivalent Direct Loan Program.

To help clarify this situation, I've asked the Director of the Congressional Budget Office to designate an appropriate CBO official to appear before the subcommittee and explain CBO's interpretation of I-MATCH's budgetary impact.

We will announce that appearance as soon as it can be confirmed. We think it will be very soon.

Well, at this point we would like to begin with our witnesses—excuse me—are there any other opening statements at this point?

Mr. McCollum. I really don't think there are. Thank you, Mr. Chairman.

Chairman Neal. Let's begin with our witnesses. And let me say to our witnesses that, without objection, we'll put their entire statements into the record and please feel free to summarize. In fact, we would like to encourage that so that we might have a little more opportunity for questions and answers.

So, at this time, we would like to start with Mr. Bengt Kjellgren.

STATEMENT OF BENGT KJELLGREN, VICE PRESIDENT, CITIBANK, ON BEHALF OF THE NATIONAL FOREIGN TRADE COUNCIL

Mr. Kjellgren. Good morning.

Chairman Neal. Good morning, sir. Thank you for being here.

Mr. Kjellgren. I'm testifying this morning on behalf of the National Foreign Trade Council. The opinions that I express are those of the council and, in some cases, my personal ones.

First of all, just to say briefly that we very strongly support the renewal of the Eximbank's charter. We would like to see it renewed for 6 years rather than 5, just because it tends to show a greater support on behalf of the Congress for the Eximbank. It is important to us that the Eximbank has as much a stability and credibility, both in the U.S. export market and among customers overseas, as it is possible to achieve.

Also, each time the charter comes up for renewal, Eximbank becomes a target for people who would like to hang amendments on the charter that really have nothing to do with financing export. To the extent that that activity can be avoided, why, it should be done.

We do have one suggestion for an amendment, a rather small one. That is, we would like to see the amendment that was passed in 1978 to section 1912 broadened so that the Eximbank can combat predatory financing in the United States from non-OECD countries, as well as from those who have signed the international accord.

I fairly recently read the administration's bill in the Senate, which proposes several other amendments to the charter. And while the National Foreign Trade Council has not considered those as such, I would just like to say my personal opinion that they all seem to be quite good; that is, one would allow directors to stay on beyond the expire of their term until such time as their successor is appointed. One would allow the Bank to charge such fees as the Bank may determine to be reasonable for work or services performed and to use those to help to support things like educational programs.

I guess their other amendment has to do with extending for 5 years the charter. As you know, we would prefer to see 6 years. And I would guess that my friends at the Eximbank would not mind seeing 6 years either.

Chairman NEAL. How about 2 years? [Laughter.]

Mr. KJELLGREN. Well, 2 years is better than nothing, of course, but it does create the problem that you then have to go through the renewal process and fight off the people who want to put in extraneous material.

Now I guess the main subject of the day is the I-MATCH, and maybe we will turn to that.

This sort of subsidy program has been used successfully in Brazil, and in Italy, to finance the exports of those countries, and it is something which, at least in principle, ought to work.

We opposed—we, the National Foreign Trade Council—opposed the I-MATCH last time because we didn't think it would work in the form that it was then proposed. It had a whole series of difficulties—technical difficulties that made it really unworkable. I think that all of our members were reluctant to abandon the longstanding Direct Credit Program that has served the U.S. export community so well.

I would say that we still like and prefer the Direct Credit Program if it can be funded in a sufficient amount so that it can back up the exports of U.S. companies.

The administration has put it to us that budgetary considerations are going to eliminate the Direct Credit Program this year, or to reduce it to a point where it would not be meaningful. And they have, therefore, suggested to us that the I-MATCH Program can be put in as a substitute, which would not be on the Federal budget.

In the process of doing this, they have also gotten the bugs out of the program; that is, all of the objections on technical grounds that we raised last year really have been dealt with in the administra-

tion's proposal. If the alternative is no Direct Credit Program at all, then, obviously, I-MATCH becomes more attractive.

We still, however, very much would like to see a Direct Credit Program.

And I would like to draw your attention particularly to page 2 of the written statement that the council has put in, where we say:

> The council's support for the I-MATCH Program is predicated upon its being put into effect with the structure and characteristics that the administration has proposed for it, in particular with regard to the assignability of Eximbank's guarantee, the ability of investors to disburse in a single installment, the protection to be provided to Eximbank against cancellation of the commitments, or prepayment of the loans, and the treatment of the program outside the Federal budget.

We have also heard the rumors that you alluded to in your opening statement that the Congressional Budget Office and the House Budget Committee are considering putting I-MATCH back on the Federal budget for the total amount of the authorized loans that would be made, and if that is true, then the principal sales pitch for the I-MATCH Program disappears.

We hope that CBO and the House Budget Committee can be talked out of that or, altneratively, can be talked into giving adequate funding for a Direct Credit Program.

That's basically what I wanted to start off with this morning.

[The prepared statement of Mr. Kjellgren on behalf of the National Foreign Trade Council follows:]

Statement of Bengt Kjellgren, National Foreign Trade Council

I am Bengt Kjellgren, a Vice President of Citibank, N.A. and am appearing today on behalf of the National Foreign Trade Council (NFTC). The National Foreign Trade Council is composed of over 500 U.S. corporations engaged in foreign trade and investment, including most of the major exporting companies of the country. The Council's Export Finance Committee, of which I am a member and former chairman, has long supported a strong and effective Eximbank.

The Council appreciates the opportunity to testify before this subcommittee which has a long-standing commitment to a strong, competitive Export-Import Bank. We commend Chairman Neal for his leadership on Eximbank issues and for his appreciation of the important role Eximbank plays in supporting U.S. exports. Because of Chairman Neal's efforts there is an increased awareness in the Congress and the Administration of the devastating effects foreign export credit subsidies have on U.S. jobs and our nation's long-term competitiveness. More importantly, the efforts of this subcommittee are clearly linked to more competitive policies within Eximbank and to improved international agreements limiting export credit subsidies.

My primary purpose in testifying today is to present the Council's views to the subcommittee on the reauthorization of Eximbank's charter and on proposed changes in the bank's credit programs. How these issues are resolved in the Congress will greatly affect our future progress in eliminating foreign export credit subsidies.

Mr. Chairman, the National Foreign Trade Council strongly urges the Congress to extend the statutory life of Eximbank for six years to September 30, 1992. We believe the time is ripe for a clear, ringing statement of support for the Bank. One of the best ways for Congress to show that support is to grant a significant charter extension. Continual short extensions merely sow seeds of doubt in our own export community and give encouragement to our competitors abroad regarding Congress' intentions about U.S. export promotion. At the same time, a long extension in no way effects this subcommittee's ability to monitor the Bank's activities by means of periodic oversight hearings. We can, therefore, have both a major show of support for the institution and its objectives, and a means of following closely its programs and policies.

The Council believes, however, that a charter extension without adequate means to assist in financing exports would be an empty gesture. That brings us to the Administration's proposal for an interest subsidy (I-Match) program as a substitute for direct lending. We must state at the outset that we much prefer a fully-funded credit program. That would be the least expensive method for the U.S. taxpayer to support an export loan program in the long run. However, the Council recognizes that additional reduction in the Federal budget deficit is a high priority for the Congress and the Administration.

After careful review of the new interest subsidy proposal, the Council believes that this program can adequately serve as a substitute for a substantial portion of the existing and time-tested direct credit program. Obviously this conclusion is subject to review of the legal documentation of the new I-Match plan; but from what we have heard and seen, we believe Eximbank and the Administration have met most of the technical objections which existed in the first interest subsidy scheme proposed last year. The Council's support for the I-Match program is predicated upon its being put into effect with the structure and characteristics that the Administration has proposed for it, in particular, with regard to the assignability of Eximbank's guarantee, the ability of investors to disburse in a single installment, the protection to be provided by Eximbank against cancellation of the commitments or prepayment of the loans, and the treatment of the program outside the federal budget. The Council also regards it as very important that the Congress view the I-Match program as a long-term commitment.

The I-match program is untested so far in the financial markets. To make sure that the Eximbank remains a credible source of export finance until I-Match is a proven success, it is important that Eximbank retain adequate statutory direct credit authority. The Council supports the Administration's proposed I-Match interest subsidy program of $1.8 billion and also a standby direct credit authorization of sufficient size to assure that Eximbank's commitments are meaningful and competitive in all cases. In order to maximize the budget-reducing effect of I-Match, the Bank should use this program to the fullest extent practicable before using any direct credit authority. In practice we believe that this will limit Eximbank's new direct loans to mixed credit situations, where the Administration does not propose to utilize I-Match funding.

I would like to qualify our general support for I-Match as it relates to Eximbank's medium term export credit program. Eximbank's medium term guarantee and credit programs are in some ways more complex than the long term direct credit program and there are, understandably, more technical problems to be solved. We have given Eximbank detailed comments on medium term I-Match and hope the issues we have raised will be resolved satisfactorily.

The Export Finance Committee of the Council has had several meetings and has conducted an intensive review of Eximbank's rechartering. After thorough study and discussion of many issues that could be raised in the context of Exim's statutory extension, the Council concluded that it should limit its comments to only a few basic matters. We believe it is far more important to renew the Bank's charter quickly and with a minimum of baggage. We therefore have only one legislative amendment to propose and three policies which we believe the Bank should modify.

The statutory provision which we propose to amend is Section 1912 of the Export-Import Bank Act Amendments of 1978. This Section provides for a means to match predatory financing offered to buyers in the U.S. by countries with which the U.S. has export credit arrangements. Some Council members are encountering this kind of competition from countries with which the U.S. does not have such arrangements. Therefore, the Council urges an amendment to Section 1912 which would make the Section applicable to any country offering financing which exceeds limits under existing standstills, minutes, or practices -- whether or not that country is a party to the arrangement itself.

Now for the policy issues. In 1983, Congress, led in large part by this subcommittee, amended the Bank's charter to emphasize and clarify its legislative mandate to meet foreign officially-supported competition. While improvements have been made by the Bank, the issue is still very much with us; and there are three specific policies of the Bank which our members believe should be modified in order for the Bank to meet its competitiveness mandate.

First, there is the issue of financing foreign content and local costs. Other export credit agencies are generally willing to provide assistance for foreign content and local costs to a far greater degree than Eximbank. While Eximbank has been willing to provide a guarantee for local costs up to fifteen percent of the contract price to meet competition, it is unduly difficult to convince the Bank that it is needed in specific cases. As for foreign content, it provides virtually no assistance in its long term direct credit and financial guarantee programs and up to ten percent in its medium term programs. Europe, Canada and Japan will cover much more, ranging from ten percent to fifty percent depending on the country and the case. Eximbank should meet that competition. In today's world, purchasing countries require a substantial local component in domestic products, and U.S. manufacturers are finding it economically necessary to enter into joint manufacturing agreements with companies abroad for manufacture of a portion of their product. A liberalization of Eximbank's policy on foreign content and local costs would go a long way to help the exportation of products which are primarily manufactured or produced in the U.S.

Second, the problem of tied aid credits continues to be a major concern to American companies. Eximbank has had a legislative direction to provide a tied aid credit program since 1983 but has been responsive to this legislation only in recent months. While there are several bills pending to provide appropriations for Eximbank to meet this predatory competition, Eximbank's responsiveness should not be contingent upon current legislative activities. Eximbank should continue the efforts it began a few months ago. Eximbank already has sufficient, explicit statutory authority to provide tied aid credits and should do so whenever necessary to meet the competition. Both the

new legislative initiative and action under existing statutory authority are necessary to bring a negotiated end to tied aid credit abuses.

Finally, there still remains the Bank's highly objectionable two percent up front application fee. While it is difficult to prove the extent of lost sales resulting from this fee, we can with certainty state that it is a great irritant to foreign buyers and adds significantly to U.S. exporters' difficulty in closing a sale. There is no clear need for this fee, and it should be eliminated or greatly reduced; and at least if it must continue, the fee should be amortized over the full life of the underlying credit.

Thank you for receiving my testimony today and I would be happy to answer any questions the subcommittee may have.

Chairman NEAL. Thank you, sir, very much.
Our next witness is Jim Nelson.

STATEMENT OF JIM NELSON, DIRECTOR, GOVERNMENT LIAISON, UNITED TECHNOLOGIES CORP., ON BEHALF OF THE COALITION FOR EMPLOYMENT THROUGH EXPORTS (CEE)

Mr. NELSON. Good morning, Mr. Chairman.

I am testifying today on behalf of the Coalition for Employment Through Exports, better known as CEE. We represent 52 export-oriented companies, 14 labor unions, and 12 State Governors.

I am going to briefly summarize the key points of our recommendations which have been submitted in the written statement.

I would like to talk about three things—length of reauthorization, some competitiveness issues which we would like to see addressed in reauthorization, and the handling of Eximbank in the budget.

The length of reauthorization is our shortest recommendation, although not necessarily the least controversial.

We agree with the NFTC that a 6-year reauthorization would be good, not only because going through it every 2 or 3 years causes all of us frequent diversions from our normal duties, but also because we think it will give some sense of permanence to the exporting community and their customers.

We have two recommendations on competitiveness, one dealing with some wording changes to try and clarify the fully competitive aspects of what we think Eximbank should do, and a second which requires some additional information in the annual report. These, again, are in the written testimony and I won't go into them.

I would like to talk a little bit about mixed credit and predatory financing because this legislation was passed as part of the Trade and Development Act of 1983 and was an addendum to the Eximbank recharter effort. We don't think that the legislation passed in 1983 has been effective in either eliminating or neutralizing the practices of predatory financing on behalf of those countries that do it.

We would like to see this strengthened in three areas. First, we would like to see the amount of funds available for mixed credits from the Agency for International Development expanded to in-

clude all nonearmarked economic support funds. Second, we would like to see the requirement for the unanimous consent of the National Advisory Council required to approve a mixed credit deal changed to only require a majority vote. And third, we would like to see that the Mixed Credit Program not only be a defensive program, but in those countries that are targeted by frequent users of predatory financing we should take an offensive position.

I would also like to go along with what the NFTC said about the Matching Credit Program and section 1912. We think that it should be amended to make it clear that this pertains to all countries that are trying to sell in the Unites States at below OECD limits with Government-supported financing, as opposed to only those who are signatory to a credit agreement in the United States.

There are a number of other competitiveness issues which we really don't think need to belong in the charter, but we would like to see in the definitive report language. I am not going to go into these in any detail. I will mention a couple of them that we have had a problem with in the past. One is the 2-percent up-front fee that Eximbank charges. We would like to see that spread over the life of the loan. The up-front nature of the fee appears to our foreign customers as an add-on when it gets passed on to them and it makes it very difficult to compete in certain cases.

We would like to see the direct credit coverage kept at 85 percent. Eximbank recently moved it there, but I think we'd like to see the intent expressed that it be kept there.

In certain cases host country costs should be considered to make us more competitive.

We would like to see, foreign content coverage to some minimal extent, where it's really not going to detract from the U.S. job base, but where it will, in fact, add to the U.S. job base by allowing an export sale that would otherwise have been lost. And we would like to see a number of changes made to the Medium-Term Credit Program, which was established in the prior rechartering effort and really has not been a workable program for either the banks or the exporters.

These are all, again, outlined in detail in the written testimony. Let me now talk about budget considerations at Eximbank.

Our position more or less coincides with what you have heard from the NFTC. We are very concerned with the amount of direct credit loan authority continuing to dwindle in the budget. Last year, when Eximbank proposed the I-MATCH Program, we all said that it doesn't work technically. It was also a little more expensive and so it got defeated.

Well, this year, I think Eximbank and the administration did a good job of listening to us. They went back and they corrected all the mechanical and technical errors. They have come up with what appears to be a viable financial tool which could supplement the long-term Direct Credit Program.

We still are reserving judgment on the Medium-Term Program until we see all the final changes being made.

In any event, we still have two concerns with the I-MATCH Program. One, it's more expensive than the Direct Credit Program because of the differential in cost of capital between a private lender and the Treasury. Second, over time, we think that it's going to

add to the depletion of Eximbank's reserve faster than the Direct Credit Program would, again because of the differential in the cost of capital.

Before we can give any definitive recommendation on I-MATCH II, we really need to examine the budgeting process for the Direct Credit Program. The manner in which the Direct Credit Program is handled in the budget, is not reflective of its real cost. Our preference would be to see the Direct Credit Program handled differently in the budget so that we didn't have the squeeze on the funds every year.

We, therefore, conditionally endorse the long-term I-MATCH II Program if it can use nonbudgeted, private sector funds to supplement direct credits.

We propose that the I-MATCH II Program work in tandem with direct credits, neither as the primary lending vehicle, nor as the secondary lending vehicle, but that they coexist on an equal basis. And we recommend that I-MATCH be funded at the level of $1.8 billion, with direct credits at a level of $1.1 billion.

Now if the budgeting process were to be changed to more accurately reflect Eximbank's costs, or if it was determined in the final analysis that I-MATCH and the Direct Credit Program would have to be scored equally in the budgeting process, we certainly would prefer the Direct Credit Program for the reasons I just stated.

Until a final determination is made, we know OMB and the administration are on one side and CBO has come out with a different ruling—but until a final determination is made, we will continue to support both programs working in tandem.

In any event, we clearly support a fully funded Direct Credit Program.

In the final analysis, if it's determined that I-MATCH II is going to be handled the same way as direct credits and, therefore, we eliminate I-MATCH II, we would like to see the best parts of the I-MATCH Program molded into some of the current Eximbank programs, and there are some good features to the I-MATCH Program.

We also believe that Congress should use this opportunity provided by the rechartering process to review the manner in which direct credits are scored in the budget.

Let me make one final point concerning the budget. Because of the real costs of the Direct Credit Program aren't reflected in the budget, we feel strongly that the unused direct credit loan authority should carry over from year to year.

This would help alleviate the current problem of the under-utilization of resources that are appropriated each year and not used. It really wouldn't have any impact on the budget because it doesn't cost any more to carry those funds over to the next year. They're already budgeted and allocated in the initial year.

That concludes my testimony. Again, we wish to express our appreciation to this subcommittee for its timely hearings.

Thank you very much.

[The prepared statement of Mr. Nelson on behalf of the Coalition for Employment Through Exports (CEE) follows:]

STATEMENT OF JIM NELSON, DIRECTOR, GOVERNMENT LIAISON, UNITED TECHNOLOGIES CORP., ON BEHALF OF THE COALITION FOR EMPLOYMENT THROUGH EXPORTS

Good morning Congressman. My name is Jim Nelson. I am Director - Government Liaison for United Technologies Corporation. My previous assignments with United Technologies have involved marketing our products to international customers. I also spent one year working at the Export-Import Bank as part of a government/industry exchange program.

I appreciate this privilege to offer some recommendations and suggestions relative to the function and operation of Eximbank. I am representing today the Coalition for Employment through Exports known as CEE, made up of 52 export-oriented companies which derive a significant portion of earnings through the export of U.S. produced goods and services, 14 labor unions whose members are heavily dependent on export sales for their jobs, and 12 governors who recognize the importance of exports to a healthy American economy. A list of our membership has been submitted for the record.

We appreciate your Committee's early and timely hearings on the reauthorization of Eximbank. The U.S. trade deficit this year is nearing $150 billion and U.S. exporters continue to be disadvantaged by foreign export financing practices. It is crucial for us to seek a competitive, aggressive and viable Eximbank.

We approach these hearings recognizing that:

1. Eximbank is an essential and needed factor in today's international competition.

2. Export financing is an increasingly critical component in the marketplace.

3. American corporations no longer have a monopoly on technology and industrial efficiency.

4. The U.S. share of the world market in many key industries has declined markedly over the last several decades.

5. Our major foreign competitors in world markets are heavily subsidized by their governments.

6. International discipline to eliminate government-aided export financing, allowing a market dependent soley on quality and price, remains elusive.

Again, CEE appreciates this Committee's invaluable support and assistance during the 1983 rechartering process when significant improvements were made to the Bank's charter. In particular, Congress directed the Bank to be more competitive in supporting U.S. exports. Unfortunately, one of our missions today is to state that despite your leadership in directing the Bank to be fully competitive, Eximbank's response to that challenge has been minimal. The Bank's use of its authority for the past fiscal year is proof of that disappointment.

CEE's main goals in the rechartering effort are:

1. To reauthorize the charter for a reasonable length of time. We feel a six year reauthorization is an appropriate time period to insure a stable footing for our sole export financing institution.

2. To further strengthen the Charter's competitive mandate both through Charter amendment and implementation directions contained in report language, and ..

3. To address in a positive fashion the severe budgetary squeeze which the overall budget deficit and fiscal situation impose on the Bank.

RECOMMENDATIONS:

Length of Reauthorization

1. As indicated, CEE recommends a 6 year extension to the Charter. The House had supported a two year extension in 1983. We feel 6 years will show some certainty relative to the Bank's permanence both to the U.S. export community and to their overseas purchasers. (Section 8 of Charter; "Until September 19, 1992").

COMPETITIVENESS ISSUE

As stated earlier, the Bank has been directed during the 1983 recharter effort to be "fully" (emphasis added) competitive with the government supported rates and terms and other conditions available in the financing of exports of goods and services from the principal countries whose exporters compete with United States exporters". We appreciate many of the recent accomplishments of the Bank which have benefitted exporters. These include negotiating concensus interest rates among OECD countries; completing a cooperative aircraft agreement among OECD countries; initiating promotional programs for exporters and banks; and more recently providing mixed credit funding in the absence of a funding mechanism and increasing direct credit coverage to 85% to be competitive with other OECD countries. (Sec. 2(b)(1)(a)) We believe the Bank has not been as competitive as Congress intended nor as aggressive as the export community feels is necessary

to help reduce the trade deficit, expand exports and keep American products competitive in world markets.

However, there are several areas where we feel Eximbank is not fully competitive which they need to address:

1. A two percent up front fee was imposed on borrowers.

2. Five years ago Eximbank Direct Credits were reduced from 85% to 65% of the U.S. export value. We applaud the recent decision of the Bank to change this policy back to the 85% cover on January 7, 1986.

3. Few Mixed credits offers have been made until the last four months and the Matching Credit Program has atrophied.

4. The Medium Term Program has significant implementation problems ranging from lack of consistency in transaction size to risk sharing.

The resources provided by Congress for the Direct Credit Program have not been used for a variety of reasons. CEE recommendations are aimed at providing further guidance to Eximbank to more competitively and aggressively use the provided resources.

CEE recommends the following actions to further insure the competitive mandate of the Bank:

First, as a Charter Amendment, delete the second sentence of Section 2(b)(1)(b) and substitute language which directs the Bank to provide financing which shall be:

> "Fully equivalent in essential terms and conditions to the export financing available from other countries and their government-related or supported agencies and instrumentalities through which foreign exporters compete with United States exporters."

This addition gives Congress's "fully competitive" mandate a clearer meaning by requiring an Eximbank financing package to be fully equivalent in terms and conditions to match those of foreign competitors.

Second, as a Charter Amendment, to require as part of the Bank's Competitiveness Report to Congress, the number of requests submitted and turned down by country and dollar level.

Mixed Credits/Tied Aid

The Mixed Credits predatory practices by foreign governments remains a severe problem. Current legislative proposals in Congress do not address the full range

of concerns of the export community to adequately combat the practices. The Tied Aid Credit Program incorporated in the Trade and Development Act of 1983 has been ineffectively implemented and should be modified to improve its operation. CEE recommends amending sections 645(d), 646(a)(2), and 644(a)(1)(b).

We recommend amending section 645(d), which now restricts AID to those "Economic Support Funds allocated for Commodity Import Programs" in financing "a tied aid credit activity." This provision restricts AID resources to a small allocation and discourages utilization of the tied aid program. Instead, AID should be able to use, at its discretion, all non-earmarked Economic Support Funds. This can be accomplished by stating that "the Administrator of AID may use funds made available to carry out Chapter 4 of part II of the Foreign Assistance Act of 1961 (relating to the Economic Support Fund) to finance tied aid credit activities pursuant to this section."

In section 646(a)(2), CEE recommends a "unaminous" consent of NAC requirement to be changed to require a majority vote of the Council. A majority vote procedure is more than sufficient and negates the ability of a recalcitrant agency to block fund use.

Finally, Section 644(a)(1)(b) should be amended to allow for both offensive and defensive use of the Bank's Tied Aid Credit Program. The Tied Aid Credit Program should be used as a negotiating tool to reduce government subsidized export financing. Its strategic use in financing exports to foreign markets which are potential markets for countries which engage in tied aid conventional financing and in matching these practices assists in that purpose.

Matching Credit Program Section 1912

In 1978 and again in 1983, Congress addressed the concern of U.S. exporters to allow Eximbank to provide financing within the United States if foreign sales to the U.S. are being offered involving foreign official export credits "which exceed limits under existing standstills, minutes or practices to which the U.S. and other major export countries have agreed."

The Congress directed the Secretary of the Treasury and Eximbank to make this Section 1912 an effective instrument to prevent foreign countries from selling their products in the U.S. using export financing which violates OECD limits. However, recent interpretation of this section appears to indicate that it cannot be invoked unless an actual signatory to a credit agreement with the U.S. violates its terms.

We recommend Section 1912(a)(1) be amended to make it clear that a matching credits is available when any country violates OECD or other agreements to which the

U.S. is a party whether or not that country is a signatory itself. We wish to note that this program should be operated in such a manner so as not to negate the Bank's primary purpose of supporting exports.

As a close to our recommendations relative to the Bank's competitiveness, we recommend definitive report language as to the intent of Congress in the following:

1. Clarify the "reasonable assurance" standard in Section 2(b)(1)(B) so the Bank's policies are not overly restrictive. A standard where one or more OECD countries have offered official export credits to the same potential customer should be a significant factor in the Bank's decision to support a U.S. offer.

2. The two per cent up front fee which the borrower is required to pay has provided difficulty for exporters since it was imposed. Other OECD credit agencies do not impose such an up-front fee and the Charter does not mandate one. CEE recommends Congress direct the Bank to spread any such fee over the term of the loan.

3. As stated earlier, the Bank has recently begun an 85% coverage policy. We recommend Congress take favorable note of this action and that this coverage remain available whenever necessary to maintain the Bank's competitiveness in this area.

4. Unlike many other OECD export financing agencies, Eximbank does not normally fund host country costs. CEE requests Congress to direct the Bank to make host-country funding available, on a case-by-case basis, where necessary to secure a U.S. sale.

5. We recommend that Congress in report language direct the Bank to review its policies with respect to the financing of foreign content in American export products in the long term program. CEE feels that permitting modest foreign content funding would not encourage outsourcing amd make us more competitive with other foreign export credit facilities which do provide foreign content coverage for their exports.

   CEE and its member labor organizations would be available to assist Exim in exploring procedures and criteria where, on a case-by-case basis, and where necessary to secure a U.S. sale, a percentage foreign content element (as the Bank now exercises in the medium term program) would be considered.

6. The Medium Term Credit Program was enacted in 1983. Its operation has been disappointing to exporters seeking to use Exim's assistance.

Many organizations, CEE included, have expressed the need for the Bank to address various inadequacies in their operation of the Program. Among these are:

1. The unnecessary linkage of the credit and the guarantee.

2. Flexibility to allow a buyer credit or supplier credit option to a commercial bank.

3. Decreasing accessibility barriers, such as requiring a commercial bank to perform as the Exporter-of-Record where this is neither a desirable or acceptable role for many commercial banks.

CEE would be very interested in working with the Committee in offering Report language which guides the Bank assessing these Administrative policies and conforming them to a pro-exporter policy.

Mr. Chairman (and members of the Subcomittee), I have just completed a rundown of the areas we feel need improvement relative to Eximbank competitiveness. These are issues which need addressing whether or not a Direct Credit or the proposed I-Match II Program exists.

I-MATCH II

Exporters, most business and export organizations, and CEE members strongly opposed the Administration's 1985 I-Match proposal on three basic grounds. First, the way in which the I-Match proposal was structured made it unattractive for the private commercial banks -- whose involvement was essential to the operation of the program -- to participate at all. Private lenders were unwilling and unable to assume the risks inherent in the 1985 program. Second, I-Match was a somewhat more expensive program than direct credits for an equivalent amount of loans because the cost of private bank borrowing would be higher than the cost of Treasury borrowing directly for Eximbank. Third, the Administration proposed to de-authorize the Bank's direct credit program.

We feel that, unlike its predecessor, I-Match II has been sufficiently improved both technically and mechanically to be considered as an additional export financing tool by the Bank. Leading private Banks have indicated they would be willing to participate and this is the key element. CEE therefore conditionally endorses the long term I-Match II program to work in tandem with the existing direct credit program. CEE wishes to note that the Direct Credit Program remains the program of preference.

CEE feels the following conditions attach to its endorsement of the I-Match II concept:

First, the I-Match II program guidelines should be as presented in early drafts and made a part of the record. Among these should be:

A. The unconditional nature of the full faith and credit guarantee to private lenders.

B. The program should offer credit at rates and or terms and conditions which are fully competitive.

C. The private institutional lender must have the ability to transfer the promissory note.

D. All costs to foreign borrowers should be equivalent with those terms and conditions available under the direct credit program.

Second, and of paramount importance to CEE, the I-Match II should work in tandem with the Direct Credit Program. It should neither supplant nor deauthorize the Direct Credit Program. We believe the two programs should work side by side.

In seeking this tandem posture, we wish to note the compelling reasons for retention of a funded Direct Credit Program:

A. The Direct Credit Program has been an efficient program which can effectively support U.S. exports in international competition when properly administered.

B. I-Match II represents a significant advance in design over I-Match I. But it has yet to be tested as to its technical aspects or its competitiveness. Its success depends in large measure on the manner in which it is operated by Eximbank and the degree to which private banks participate, given changing international fiscal and economic scenaries. There would be an inevitable rough spots to be worked out. While this testing period is on-going, Direct Credits must continue to exist to assure U.S. exports of support.

C. There may be occasions when no private lending institution will bid on a particular sale. Without a Direct Credit Program that sale might be lost to the U.S. exporter. This is a particular problem with the medium-term market where many regional banks are withdrawing from the market due to low profitability and considerable regulation.

D. Maintence of a Direct Credit Program allows Eximbank to remain a credit bank, which is of importance in its negotiations with foreign official credit facilities in reducing or eliminating foreign subsidized rates. We echo a Commerce Department memo of last year directed at I-Match II. Commerce stated that "Unilateral action by the U.S. Government to withdraw from direct loans weakens the leverage available to the U.S. negotiators. The foreign competition will take full advantage of this situation."

E. Due to the authority limits the Administration is seeking for I-Match II of $1.8 Billion in exports, demand may exceed available resources without a Direct Credit Program. A project may be too large or have too long a draw-down period for Eximbank to fund the full subsidy amount. In these cases, a Direct Credit Program assures continued flow of assistance to U.S. exports.

F. The Direct Credit Program may be a better vehicle for special uses, such as mixed credits, matching credits or the export expansion fund.

In fact, if a decision had to be made between the two, the direct credit program remains the CEE program of preference because it is a proven program.

Third, CEE is pleased that in a February 3rd draft, Eximbank has corrected a number of deficiencies in its January 14 draft on the Medium Term I-Match Program. These new guidelines appear to contain many of the improvements sought by our members. In the spirit of continued cooperation and with the understanding that the remaining areas of concern can be addressed, CEE is prepared to support the medium term I-Match II effort as well.

A final point needs to be made concerning Eximbank and the budget. The manner in which Eximbank direct credits are handled in the budget is not reflective of actual Eximbank outlays on a yearly basis. CEE would prefer to see Eximbank either taken off budget or more accurately reflected in the budget. The current budgeting process has the effect of limiting funds available for the direct credit program.

We do not expect that the budgeting process will be changed. Therefore, we see the merit in I-Match II because it can use non-budgeted private sector funds to suppliement direct credits in meeting exporter needs. However, we are concerned that continued use of I-Match II would add to the depletion of Eximbank's reserves over time. If the budgeting process were to be changed to more accurately reflect Eximbank outlays, or I-Match

II and direct credits were treated equally in the budget, CEE would prefer the direct credit program for the reasons outlined previously in the testimony.

Given the difficult budget environment in which Congress must act this year, CEE is not recommending any major budget changes. However, we do feel that, because of the budgeting anomoly discussed above, unused direct credit loan authority should carry over from year to year. Therefore, CEE recommends that Congress permit a "no year" appropriation for Eximbank on which unused budget authority can be carried-forward to succeeding years, without being scored again, or, at least, that such authority be carried over for the next succeeding fiscal year. This would help alleviate the current problem with the Bank's under-utilization of the resources Congress has given it and, yet, it would not impose an additional cost in the budget, since full budget authority would be "scored" in the initial year of the appropriation. It would also temper the annual budget battles which are so time consuming the debilitating.

I again wish to express my appreciation to this Committee for these early and timely hearings. Eximbank is an essential and needed factor in today's international competition. Without it, American exporters are at a distinct and substantial disadvantage. We thank you for your willingness to consider our suggestions for constructive changes to the Bank charter and operations.

Thank you.

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Coalition for
Employment Through
Exports, Inc.

USA

1801 K Street, N.W.
8th Floor
Washington, D.C. 20006

Telephone
202-296-6107

COALITION FOR EMPLOYMENT THROUGH EXPORTS

Membership as of January, 1986

A. Business Organizations

1. Aerospace Industries Association of America, Inc.
2. Air Products & Chemicals, Inc.
3. Allis-Chalmers
4. American Textile Machinery Association
5. ARMCO, Inc.
6. Avco Corporation
7. Bank of America
8. Bechtel Group, Inc.
9. BF Goodrich Company
10. Blue Bird Body Company
11. The Boeing Company
12. Bucyrus-Erie Company
13. Caterpillar Tractor Company
14. Chase Manhattan Bank
15. Deere & Company
16. Dresser Industries, Inc.
17. Ducommun Incorporated
18. E.I. Du Pont De Nemours & Company
19. First Wisconsin National Bank of Milwaukee
20. Fluor Corporation
21. GATX Corporation
22. GTE Corporation
23. General Dynamics Corporation
24. General Electric Company
25. Goulds Pumps, Inc.
26. Gulf & Western
27. Hughes Aircraft Company
28. Lear Siegler, Inc.
29. McDermott Incorporated
30. McDonnell Douglas Corporation
31. Manufacturers Hanover Trust Company
32. Morgan Guaranty Trust Company
33. Morrison-Knudsen Company
34. National Association of Export Companies, Inc.
35. National Machine Tool Builders Association

36. Northrop Corporation
37. PACCAR, Inc.
38. Pennsylvania Engineering Corporation
39. Pneumo Corporation
40. Raytheon Company
41. Rockwell International
42. Rohr Industries, Inc.
43. The Signal Companies
44. Sperry Corporation
45. Stone & Webster Engineering Corporation
46. Sundstrand Corporation
47. Textron Incorporated
48. Transamerica Delaval Incorporated
49. United Technologies
50. U.S. Steel Corporation
51. Wean United
52. Westinghouse Electric Corporation

B. Labor Organizations

1. American Federation of Government Employees
2. Building and Construction Trades Department, AFL-CIO
3. Coalition of Labor Union Women
4. Communications Workers of America
5. Council of Engineers and Scientists Organizations
6. International Brotherhood of Electrical Workers
7. International Ladies' Garment Workers Union
8. International Union of Electrical, Radio and Machine Workers
9. International Union of Operating Engineers
10. The Seafarers International Union of North America, AFL-CIO
11. United Association of Plumbers and Pipefitters
12. United Automobile, Aerospace and Agricultural Implement Workers of America
13. United Brotherhood of Carpenters and Joiners of America
14. United Steelworkers of America

C. Governors

1. Governor Bob Graham of Florida
2. Governor Bruce Babbitt of Arizona
3. Governor William A. O'Neill of Connecticut
4. Governor George R. Ariyoshi of Hawaii
5. Governor John V. Evans of Idaho
6. Governor James R. Thompson of Illinois
7. Governor John Carlin of Kansas
8. Governor Harry Hughes of Maryland
9. Governor Rudy Perpich of Minnesota
10. Governor Victor G. Atiyeh of Oregon
11. Governor Dick Thornburgh of Pennsylvania
12. Governor William J. Janklow of South Dakota

Chairman NEAL. Thank you, Mr. Nelson.

Let me just say, as I understand it, the OMB has some sort of internal guideline of its own that would prohibit it, if it were to follow it, from these kinds of smoke-and-mirrors that they have tried to do with this I-MATCH Program. So I just notice that Mr. Kjellgren suggested that this might not be, you know, it might not end up with the Congressional Budget Office treating it this way.

The Congressional Budget Office, let me just point out to the witnesses, made this decision completely on their own. We had nothing to do with it. They came to this conclusion. It is an obvious conclusion, to anyone that would take the briefest look at it.

They are playing games over there.

Now, can they get away with their games? Who knows? They get away with most of them. But I just thought you would find that of interest. I just have a feeling that, in this case, the Congressional Budget Office will probably carry the day, but I don't know for sure.

Our next witness will be Mr. Pierce of the Boeing Co.

STATEMENT OF J.B.L. PIERCE, TREASURER, THE BOEING CO.

Mr. PIERCE. Thank you, Mr. Chairman. The charter is up for renewal and renewal is a key word to emphasize. It's an opportunity to take a look at the policies which respond to the needs of U.S. exporters to compete in a hostile environment.

First, some comments about I-MATCH.

Last year, as you know, Senator Domenici requested a survey be conducted among exporters in the financial community about the efficacy of I-MATCH. There were many shortcomings and this was reported to you in testimony last March 6. Congress wisely rejected the proposal.

This year, the adminstration has proposed an improved I-MATCH and Exim has done a good job in adopting some of the ideas that came out of the Domenici survey. But there are still some technical shortcomings.

However, before these problems are discussed, it's necessary to state that the exporters of the group have reluctantly addressed I-MATCH II due to the Federal budget pressure. Now if CBO does, in fact, determine I-MATCH is identical to Exim direct credit, then what sense does it make to go into the program?

While we ponder budgetary impacts, several of our major trading partners, it might be underlined, such as Canada, and such as Japan, still have direct funding capability.

The technical problems of I-MATCH range all the way from items like withholding tax and documentation to somewhat more expensive features such as the need to tap on a single draw long lead time advanced payments which require the warehousing of funds.

Exim might think about retaining a Direct Credit Program and using that as the revolving fund for the long lead time big ticket items because that would be the most efficient use of capital, the smart combined use of private and public capital.

Another reason why preservation of Exim direct credit may be necessary is due to the predicament of the Third World. In certain

cases, even with an Exim guarantee, commercial banks are not responding. This is because many banks face limitation in terms of what's called country limit. I am not talking about country risk, but country limit—the total amount of credit which may be extended to country *X*, regardless of whether or not it has an Exim guarantee.

Banks do not extend credit based on the assumption that the bank expects in all likelihood to call upon the guarantee, that being a most probable event.

We at Boeing have run into difficulty putting export finance and deals together with an Exim guarantee—in Brazil, Yugoslavia, Mexico, and Argentina are examples. And undoubtedly smaller exporters with fewer private capital sources to mobilize have encountered even greater problems.

Let's be straightforward about the conditions in the Third World. There are going to be more reschedulings, especially now with the oil prices falling. Beyond the key LDC's of Mexico, Nigeria, Indonesia, Venezuela, if the banks face further rescheduling, it's likely their senior credit committees will pull in their horns in other Third World countries as well.

Recent statements from the Cartagena group of debtor nations suggests that the LDC's are reaching a stress point in debt servicing. They are not willing to devote all of their foreign exchange earnings to repayment of older outstanding debts. They cannot tolerate the political and/or economic instability.

If further restrictions are placed on such nations which urge them to export, but not to import, it's the U.S. exporter who is going to be hurt, as well as the Third World country that needs such U.S. goods to assist in their economic recovery and growth.

Why not consider an Exim direct credit program which addresses the need to keep open the channels of U.S. trade to such countries and coordinate it with the Baker plan?

Recently, Exim has refused in certain cases to provide Exim credit or guaranteed support because that particular country is about to reschedule its debt obligations.

One case we know of recently has been Morocco, even though Morocco is on the Baker list of the 15 countries. Why not tie the Baker plan through Exim to a special Direct Credit Program which addresses the special needs of the Third World anticipating the need to reschedule?

Such reschedulings are going to occur anyway and there is no other choice. By tying a special fund in Exim using direct credit, in those cases where private banks will not respond with an Exim guarantee, such markets remain open to U.S. exporters.

Our foreign competitors will use trade credits to expand market penetration, I can assure you. Our European competitor, Airbus, has taken into account the question of rescheduling. In a recent Brazilian newspaper, addressing a current campaign going on between Boeing and Airbus, an Airbus executive was quoted as saying that the sale of Airbus equipment would be folded into the rescheduling process.

If our competitors are offering trade credits, Exim must be prepared to do so as well in the Third World nations.

Now I would like to talk about the Exim financial guarantee program because that's one of the most curious maneuvers which Exim has executed in coming up with their I-MATCH Program.

I am not sure if this subcommittee is aware of the fact that Exim is willing to improve the Exim financial guarantee folded into the I-MATCH Program, but was not willing to improve the financial guarantee program standing alone.

This is a pure contradiction of the intent recently espoused to privatize Exim more by relying more upon private capital sources. Hence, one of the anomalies of the Exim policy under I-MATCH II is that I-MATCH will improve Exim's guarantee, the financial guarantee as to assignability and so forth, but does not do so when the financial guarantee program stands alone.

Yet, if the Exim financial guarantee were improved, it is quite likely many of the export transactions could be effectively accomplished just using the guarantee, which is just pure cover, without any subsidy, especially in category 1 and 2 countries under the OECD arrangement and all transactions under the Commonline aircraft agreement. With an effective and improved Exim guarantee, we could tap the private funds below the arrangement or Commonline rates easily.

We did so last year. Boeing customers did not use any of Exim direct credit last year. They used only the Exim financial guarantee and mobilized private capital.

We were able to help and obtain the quotes below the commonline rate, which is pegged biweekly. We did this by mobilizing capital, using what I would call the Exim impaired financial guarantee. However, we have a broad range of capability within the national financial community to ferret out the best source of funds using the Exim guarantee, using swaps, reverse swaps, and so forth.

With a more acceptable and an improved Eximbank financial guarantee, we could do an even better job, thus avoiding the use at any time in the future of Exim direct credit.

Other exporters, especially the smaller exporters, if they were provided with a cleaner, more assignable, more receptive Exim financial guarantee, would also be able to find private capital that was willing to quote rates beneath the OECD arrangement.

Why hasn't Exim improved the financial guaranteed standing alone? It has been represented that the U.S. Treasury would oppose such a maneuver. And yet, it is U.S. Treasury that continues to espouse the merits of reaching market rate and market term. It would seem more logical for Treasury to concentrate on the international negotiations with our partners, our trading partners, to be sure that the spread between the Government cost of borrowing and that of the official export rate and of the Commonline rates were of sufficient margin to permit private capital to be used only with a guarantee.

Simultaneously, Exim should be given every opportunity to mobilize the full capital market resources to keep a combined Exim guarantee and private capital below the official export rates.

This is especially so since the Europeans are now focusing how to improve their financial guarantees and to tap the private capital markets using their guarantee or just pure cover.

In fact, the Europeans are venturing already into a recent development of the world's capital markets called securitization. Morgan Grenfell recently took the guarantees of ECGD, the British exporting financing agency, and SACE, the Italian export agency, and securitized such guarantees in the institutional capital markets. They gathered up previous loans which had been carried at higher private interest rates and reissued them in the institutional private capital markets at lower rates, thus reducing the costs of export financing subsidies and assisting Third Worlds in rescheduling of debt.

When we look at Exim's future, we have to look at the movement toward securitization, which gains access to the best, more competitive private interest rates achievable in the world capital markets. And that's where the action is.

One other item I would like to talk about is foreign content. We would hope that Exim would adopt a more cooperative approach, a more dynamic approach to the problem of how to export finance big-ticket U.S. capital goods which have foreign content components. Currently, Exim provides only cover of up to 2 percent of major big-ticket capital goods, like aircraft or nuclear powerplants.

Yet, the net U.S. content is so great on such big ticket items, that this is where most of the export bang for the buck lies. Surprisingly, for short-term suppliers, Exim allows up to 50 percent foreign content.

Now some may advocate that Exim provide up to 20 pecent cover for foreign content for big-ticket items. This would be a help, and it may prove necessary. But there's still a better way, and that is the development of a more effective cooperative agreement by Exim with other OECD export agencies, such as EDC of Canada, SACE of Italy, and so forth, to develop cofinancing schemes.

These cofinancing schemes advocate that each export agency be responsible for their own local content, with a reciprocity and funding guarantee support to permit the lead export agency—that is the one that has the largest content—to package the deal effectively.

Let's take the 767 as an example. Eighty-nine percent of the sales price is U.S. content, 5.5 is Japanese, 3.6 is Italian, slightly over 1 percent is Canadian. What we are trying to do at the present time is pull a consortium together which, in fact, each export agency would cover their own goods and services.

However, a cooperative cofinancing scheme needs reciprocity. There are foreign products with U.S. content and Exim has been invited by foreign export agencies in the past to participate with them in the package financing, with Exim only to cover the U.S. content. And incidentally, in some cases, that U.S. content has been as high as 50 percent.

Exim has taken a narrow approach, unwilling to accept the cofinancing scheme. Yet, the internationalization of major big-ticket capital goods is a growing development. One way to avoid disputes and misunderstanding between export agencies is to seize upon opportunities which permit them to work together. Cofinancing is one of these ways.

While foreign export agencies have been willing to pick up U.S. content to some degree over a period of time, in the absence of co-

financing agreements with Exim to support its own U.S. content, eventually, such export agencies begin to develop packages which encourage the use of components which are of origin in other countries.

In essence, by refusing to engage in cofinancing, a distortion of trade patterns begins to emerge. We are not ahead of that game.

Before closing, I would like to say that Exim has been very innovative in the last year in several areas. For example, in the case of leasing and in the case of political risk confiscation policy, which introduces it into asset-based financing techniques. The Exim people are competent, professional and they deserve our support.

Thank you for the opportunity.

[The prepared statement of Mr. Pierce on behalf of the Boeing Co. follows:]

REMARKS

OF

MR. J. B. L. PIERCE

TREASURER, THE BOEING COMPANY

BEFORE THE

U.S. HOUSE OF REPRESENTATIVES

COMMITTEE ON BANKING, FINANCE AND URBAN AFFAIRS

SUBCOMMITTEE ON INTERNATIONAL TRADE, INVESTMENTS

AND MONETARY POLICY

FEBRUARY 20, 1986

Mr. Chairman, Members of the Committee, I am most pleased to appear before you today to address this most pressing of subjects - the future of the EXPORT-IMPORT BANK and its vital role in American trade policy.

This year, I was asked in a letter from Senator Garn and Representative St. Germain to form an ad hoc group of experienced members of the financial and export community to analyze various proposals of change in the EXIMBANK operations and policies, as we approach the Bank's charter renewal later this year. I believe I have gathered some ideas which are responsive to both the need to observe restraint in federal expenditures and to maintain continuing aggressive support for United States' exports.

THE CURRENT SITUATION

It seems that in recent years, exporters have faced the same rather peculiar task - defending the concept and role of the Bank at a time when America has faced unprecedented foreign competition. Of course, much of this foreign competition has thrived on foreign government subsidies and other forms of support, both overt and covert, and the United States has come away from this encounter with a gaping trade deficit. Yet last year, as this deficit exploded to the $150 billion level, the exporter community was kept busy here on the Hill; not, as one might expect with proposals to strengthen the Bank, but rather with fighting efforts to dismantle it. With much credit due to this Committee, those proposals were unsuccessful and the Bank remains able, if not always willing, to do what it was established to do.

As a critical element in American trade policy, the Bank is needed now more than ever to protect America's declining competitive position in international markets. This is one issue which joins all Americans affected by the currents of trade - businessman and laborer, the exporter and the supplier, the prime contractor and the subcontractor, the workman on the assembly line and the one facing the unemployment line. So long as the United States faces unfair foreign government-supported trade practices, the Bank is a needed tool for redressing the imbalance and protecting American manufacturing and jobs.

CHARTER EXTENSION

The Boeing Company therefore joins the Coalition for Employment Through Exports, among others appearing before this Committee, in urging an extension of the Bank's charter. Boeing supports an extension of at least six years. A significant period of time is required to clarify for all concerned, American exporters and foreign competitors, that the United States is committed to the defense of its exports against unfair foreign competition. Continuous uncertainty about the future of the Bank, including recurring Congressional debate about its future, undermines exporter and financial community confidence in the Bank and ultimately limits its effectiveness.

There is an additional reason, as well, for a sustained commitment to the Bank, namely, the need for some period of time in which the Bank may test and develop new programs and approaches to the cost-effective support of American exports. If there is any one theme which I would leave with you today, it is this - that there is much the United States can do, that is both aggressive and imaginative, which would enhance the performance of the Bank without aggravating current budgetary pressures.

CHARTER RENEWAL

Allow me to begin with the central proposition that in proceeding with charter renewal, Congress should not stop at extending the life of the Bank. The charter should truly be "renewed" in the deeper meaning of the term - revitalized to meet the emergencies of the current United States trade situation.

I-MATCH II

Any discussion of change in the Bank programs must begin with I-Match, now in its second edition as I-Match II. I am pleased to say, it represents a genuine and commendable effort by the EXIM to come to terms with the objections of exporters and commercial banks to the gross deficiencies in the original proposal. Indeed, at the request of Senator Domenici, I directed a survey

of commercial banks, known as the Domenici Survey, completed in March, 1985, which outlined those deficiencies and, presumably, contributed to the Bank's development of I-Match II.

I-Match II, while a marked improvement over its predecessor, continues to merit careful attention. I urge specifically that, in thinking about this program, Congress bear in mind two polar concerns - what this program cannot be, and yet what it must be.

At the present time, I-Match II cannot be a substitute for, much less an argument against, Direct Credit. Direct credit remains necessary and useful as a tool to meet certain needs for which I-Match would be irrelevant - such as the mixed credit and matching (Section 1912) credit programs of the Bank. Moreover, there are certain projects which, because of their size, duration or the risks involved, appear doubtful candidates for full financing under I-Match and which would require Direct Credit support.

Finally, we cannot be sure that I-Match will produce the results its authors claim and that exporters would hope for. To phase out Direct Credit, when the future of I-Match is unknown, is a clear case, literally and figuratively, of betting the Bank.

And there is that which I-Match must be - imaginatively and constructively designed to attract the widest possible range of commercial banks and other private capital sources. I-Match can work, but only if it is allowed to function as an incentive for private capital participation in Bank programs.

As an example, the Bank has moved tentatively into the direction of allowing transferability of the I-Match commitment - both the guarantee and the interest subsidy payment. Yet, at the same time, this critical feature, as proposed, is restricted and subject to conditions. The Bank permits, for example, the option of a one-time transfer to trust from which "certificates of participation" would be sold to investors. Potential investors would likely find this investment to entail some considerable measure of risk associated with the vagaries of trust management. As a result, there would likely follow a demand for higher yield on this investment - and thus a higher price for this investment in the first instance.

It would seem generally that it would behoove the Bank to assemble an I-Match with more, rather than less, appeal to the private sector. If, as its authors hope, I-Match can eventually limit the government's role in subsidizing U.S. exports, substituting in the government's place the power of private U.S. capital, it would follow that the government should avoid laying too heavy a hand on the design of the program in the first place. Private capital needs a helping hand, not a heavy one. With a little help, our private capital markets could do the job.

Specifically, I would recommend that the Bank be directed to provide for the following:

- o the most flexible possible subsidization of interest rates on floating as well as fixed rate terms;

- o full or substantial transferability, with a minimum of restrictions likely to impede private capital participation;

- o allowance for the making of loans in convertible foreign currencies, including Bank authority to enter into transactions providing for exchanges and options of, and other access to, foreign currencies and interest rate maturities;

- o provision for Bank payment of any and all costs to foreign borrowers which are not presently borne by borrowers under current direct programs of the Bank;

Congress must pay close attention to details, in both its review of I-Match II and in its enactment of enabling legislation.

Serious technical questions remain regarding I-Match:

First, for long lead-time items, it is proposed that EXIM would simply drawdown the funds in one immediate traunche - and then "warehouse" the funds - until such time as they are used in the drawdown schedules. This could extend for up to a five-year period. Wouldn't it be better to preserve some Direct Credit as a revolving fund at EXIM to handle the period of lengthy drawdown - and avoid the expensive cost of warehousing?

I'm told - a possibility is being considered by EXIM to counter this problem of warehousing with a special corporation or PEFCO which, in effect, would be used to temporarily fund the several drawdowns through using short-term borrowings to reduce the cost. Will the Treasury permit EXIM to setup such a special corporation - or use PEFCO? If so, then EXIM should simply open it to competitive bidding, i.e., it should be extended on a competitive basis to all institutional investors in open bidding. This would reduce the cost of borrowing.

Nevertheless, either system - other than an EXIM Direct Credit fund would be time consuming . . . and not as efficient as direct credits.

Second, there is a bothersome tone of simplicity in EXIM's description of the implementation of I-Match. This oversimplification deserves to be challenged. The mechanics of putting I-Match into place in the financial community will be much more complicated than presently envisioned. Contracts will have to be drawn, documentation will have to be compiled and studied for marketability, liability analysis will have be performed and a system of controls must be put into place.

Third, there is the question of how the Internal Revenue Service will treat the Bank's income under I-Match with respect to the status of foreign national withholding taxes. I don't propose to describe this potential problem in detail today, but I know it will surface before the banks participate in any I-Match financing.

Most banks today are very cautious about getting into any new programs which might adversely affect their balance sheets or operating statements. There are many alternative investments which offer the banks a much higher return on their investment than one or two percentage points, even if it is relatively low risk. Deregulation of the banking industry has produced increased competition for bank resources, and the cost of these funds are higher today as a result.

All of the remarks concerning I-Match are qualified, of course, because if the Congressional Budget Office determines that I-Match is identical in its Budget impact to EXIM's Direct Credit Program, there would be no sense in adopting a program. It will cost some $25 to $30 million more. EXIM Direct Credit, in fact, is the most efficient and cheapest way of raising capital. It should be noted in this highly competitive world trade environment that two of our strongest trading partners - Japan and Canada - do have direct credit programs.

OTHER NEW DIRECTIONS

This year should not be the closing, but rather the beginning of a new chapter in EXIM growth. More than anything else, I believe that Congress must search hard, this year and beyond, to find other innovative ways in which EXIM can assist an expanded U.S. export support program. Those ways may turn out to be unlimited - and our success in finding and implementing them will move the Bank rapidly on a course toward cost-effective discharge of its mandate. Let met suggest here several possible directions for the future, which I offer as an executive with years of experience in the business of finding financing for American exports.

1. Improved Guarantee Program

I suggest, first, that the Congress should consider why the regular Bank guarantee should not include, as the proposed I-Match would, a transferability feature. The Bank guarantee improved in this fashion would represent a simple but dramatic step in enlisting the powers of the free market in support of important governmental export support objectives. An enhanced guarantee would attract more participation in Bank projects which would, in turn, bid down interest rates on financing offers. This improvement in the interest rate offerings would, in turn, aid in limiting the exposure of the U.S. government in the event of default.

This result would also support the I-Match II proposal when and if it is a Bank program. Additional classes of potential investors may be attracted to bid on I-Match obligations because of the transferability feature. If, however, the regular financial guarantee program of the Bank lacks this feature, there may be an impediment to continuous downward pressure on the interest rate offers on I-Match loans. If numerous investors bid on an I-Match package, driving the interest rate down to or below the OECD consensus rate, the loan would not require interest subsidy and might otherwise fall into the regular financial guarantee program of the Bank. If this program does not provide comparable transferability rights, potential investors might not permit the rates to be pushed below the OECD consensus rate.

Last year, Boeing customers did not use any of the EXIM Direct Credit facility, only the EXIM Financial Guaranty -- and with it were able to mobilize private capital - to offer export financing. We were able to do so and still obtain quotes below the Commonline Official Rate, which is pegged to the government cost of funds. We did this by efficiently locating private capital and using what I will call the "impaired" EXIM Financial Guaranty. This way, we were able to avoid any use of subsidized funding or Direct Credits. Boeing has a broad range of capability in the international financial community to ferret out the best sources of funds on a worldwide basis. Other exporters, especially smaller exporters, if they were provided with a "cleaner," more assignable and more receptive EXIM financial guaranty might also be able to find private capital that was willing to quote rates below the OECD Arrangement in Category I and Category II countries - at minimum.

I know it has been said that the U.S. Treasury would oppose an improvement in the EXIM financial guarantee program. Yet, the Europeans are working on precisely this kind of improved guarantee, for the benefit of their exporters. In a recent Morgan-Grenfell transaction, two European export credit agencies used a technique called "securitization" to reduce the cost of funds - and therefore, the subsidies they assumed.

When we look at EXIM's future, we must look at the movement into "securitization" which will assure gaining the best private capital market rates achievable in the world's capital markets. That's where the action is. In order to do so however, EXIM must address the need to improve the assignability and other features of the EXIM financial guaranty to reach the most efficient sector of the private capital marketplace.

Securitization is, in simple terms, the process of converting a buyer's obligation into a marketable security where the lending agency receives its funds, and services the two parties to the transaction. It encourages the maximum amount of competition among the sources of capital and, therefore, carries a lower cost.

In my research for this testimony, I have come across a growing attention to securitization across a widening spectrum of capital goods financing. Like Fannie Mae, Ginnie Mae and Sallie Mae operations involving long-term marketable obligations, there is a medium-term facility available through Pacific Overseas Finance Corporation, called GINEX. POFC is one of EXIM's largest users of its medium-term insurance and guaranty facility. With the EXIM guarantee/insurance accompanying the original buyer's obligation, GINEX can sell securities to investors, collect on the loan and service its commitments under the securities. This is securitization under the medium term guarantee/insurance program; and it should be extended in principle and operation to the regular guarantee program of the Bank. Infrastructure is the key - and not available for long-term financing - yet.

If we improve the features of the EXIM Financial Guaranty Program, itself, it may very well be that Congress does not have to worry about any subsidization or any I-Matches to achieve the goals we all seek. EXIM will be paid for issuing an efficient guaranty - but it won't have any subsidization, which reduces the limited financial reserves of EXIM. It won't have to worry about negative reports from the GAO about further dimunition of its financial strength.

Those who espouse the value of the private capital markets should be willing to implement programs which permit us to use to the maximum, efficient use of such private capital markets - rather than come up with awkward half-solutions.

The best course if for EXIM to approach the "securitization movement" head on with full force. And the U.S. Treasury should support this movement by developing an effective EXIM Financial Guaranty Program which permits the institutional investors to respond more efficiently, most cost-effectively. Combined with the EXIM guaranty, we have the best of both worlds. EXIM can be "privatized" by using private capital funding, but only if it is done most efficiently. The securitization movement is already out there to be used effectively.

This assumes, of course, that the OECD Arrangement Rates and Commonline Rates can maintain a proper "spread" to permit private capital to quote underneath these official rates. What if the negotiations fail? The effective officially supported export financing rate falls beneath the OECD Arrangement (which is what happens when mixed credits are tossed in). It seems to me that this is where Congress must decide to place the so-called War Chest of $300 million. And if it is with the EXIM, then it must be in the form of Direct Credit Program, as well, which would be far less costly than trying to subsidize it through an I-Match. Of course, if the new War Chest Fund is passed and controlled by the U.S. Treasury, then there is no problem.

2. Financing Foreign Product Content

American exporters face the problem of financing U.S. exports with foreign content, much as European financing agencies must address the support of their products with U.S. content. EXIM has been invited to participate with other export credit agencies in the package financing of their national exports which contain a high - and sometimes over 50% - U.S. content. EXIM has a very narrow approach to the former, and is unwilling to accept the latter.,

A real chance to foster U.S. exports is being missed - particularly in the "big-ticket" items where EXIM can produce the biggest economic impact for the commitment involved. But more importantly, EXIM should be pursuing a co-financing agreement among the OECD member countries to provide the foreign buyer 100% financing of all nations' content in major capital goods.

The absence of a dynamic, cooperative co-financing arrangement among the major industrial nations is creating unnecessary distortion. The net result may be to create a shift in sourcing patterns among competitors.

EXIM needs to take a more cooperative approach - adopt a more dynamic policy - toward the problem of how to export finance the foreign content components of a U.S. product, e.g., big-ticket capital goods export products. Currently, EXIM will only provide cover for up to two percent of a major big-ticket capital goods item like aircraft, or nuclear power plants. Yet, the "net" U.S. content is so great in such big-ticket items that it's where most of the bang for the buck comes from in such products. These are the high-performing U.S. export sectors.

Surprisingly, for short-term supplier items, EXIM allows up to 50 percent foreign content.

Some advocate that EXIM provide up to 20 percent cover for foreign content of major big-ticket export items. This may prove necessary. There is still a better way, however, and that is to develop a more effective co-operative agreement by EXIM with other OECD export agencies, such as EDC (Canada) and others to develop co-financing schemes. In essence, what these co-financing schemes allow is for each export agency to be responsible for their own local content that goes into a major big ticket capital goods export.

Let's take the Boeing 767 as an example. In such a case, 89% of the sales price is U.S. content and would receive EXIM support. The next 5.5% is Japanese content and would receive The Export-Import Bank of Japan support. The next is Italian - equal to about 3.6% - and would receive support from SACE - the Italian export agency. Another 1% plus is produced in Canada - and would receive Canadian EDC support. The remainder comes from smaller sources and would be covered by EXIM as de minimus.

Now, there are foreign products which have U.S. content. EXIM has been invited by foreign export agencies to participate with them in the package financing of their national exports to cover the U.S. content. Incidentally, the U.S. content in some cases have been as high as 50%. EXIM has taken a very narrow approach and is unwilling to accept a co-financing program. Yet, the internationalization of major big-ticket capital goods items is a growing development. One way to avoid disputes and misunderstanding among various export agencies is to seize upon the opportunities which permit them to work together. And co-financing is one of those ways.

In Canada, for example, U.S. components of some high technology exports are an essential ingredient in the final product. School buses, locomotives, aircraft and very large, off-the-road mining trucks contain engines and major assemblies from U.S. factories which compete together with Canadian exporters for sales. The list also includes satellite systems, air traffic control systems, and a variety of processing and process control systems which contain U.S.- origin technology. EXIM has been asked to participate with Canada's Export Development Corporation in the financing of the U.S. content, but has refused.

Although foreign export agencies have been willing to pick up U.S. content to some degree over a period of time - and in the absence of any co-financing agreement with EXIM to support its own U.S.-sourced goods - eventually such export agencies begin to develop export packages which encourage the use of components which are either of origin within their own country - or of origin of another country which is willing to pick up its obligation to finance its sourced material. In essence, by EXIM's refusal to engage in co-financing programs, a distortion of trade patterns begin to emerge.

3. The Third World Market

Another reason why preservation of an EXIM Direct Program may be necessary is due to the predicament of the Third World.

In certain cases, even with an EXIM guaranty, commercial banks are not responding to provide loans. This is because many banks are limited in terms of total "country limit" - the total amount of credit which will be extended to country "x" regardless of whether or not an EXIM guaranty supports the transaction. Banks do not extend credit anyway on the assumption that it will be necessary to call upon the guaranty as the most likely event. We have run into difficulty in putting export financing deals together - with an EXIM guaranty - in Brazil, Yugoslavia, Mexico and Argentina.

Let's be straightforward about the Third World. There are going to be more reschedulings - especially with oil prices falling which immediately affect key LDCs such as Mexico, Nigeria,

Indonesia and Venezuela. If banks face further rescheduling in such countries, it is likely their senior credit committees will take a more conservative look at other Third World nations.

Recent statements from the Cartagena Group suggest that LDCs are reaching a point where they are not willing to devote most of their foreign exchange earnings simply to repay older outstanding debts. They cannot tolerate the restrictions imposed and maintain a reasonable trading structure - both imports and exports.

Yet, if further restrictions are placed on such nations which urge them to export but not to import, both the U.S. exporter is hurt and the Third World country that needs such capital goods to recover their economic growth.

Why not consider an EXIM Direct Credit Program which addresses the need to keep open the channels of U.S. trade to such countries as those identified under The Baker Plan.

Recently, EXIM has refused - in certain cases - to provide EXIM credit/guaranty support because that particular country is about to reschedule its debt obligations. In one case we know of, it was a country - namely, Morocco - which is on Secretary Baker's list of 15 countries to be included within The Baker Plan.

Why not tie into The Baker Plan - through EXIM - a special Direct Credit Program which addresses the special needs of Third World countries which anticipate the need to reschedule. Such rescheduling will occur anyway. There is no other choice. By tying a special fund at EXIM - using Direct Credit - in those cases where banks will not respond even with an EXIM guaranty, such markets could remain open to U.S. exporters.

I can assure you that our European competitor Airbus has taken into account the question of reschedulings. In a recent Brazilian newspaper, an Airbus executive was quoted as saying that the sale of Airbus equipment would be folded into the rescheduling process. If our competitors are offering trade credits, EXIM must be prepared to do so as well.

CONCLUSION

I could add here more examples, more proposals, more opportunities for innovative and cost-effective Bank support for U.S. exports and trade. The theme, I hope, is clear at this point - that the renewal of the EXIM charter comes at a critical time in U.S. trade relations, when this renewal can achieve much more than a simple extension in the life of the Bank. We can update our approach to our trading problems, taking into account both new budgetary realities and the opportunities for improved private capital partnership with the government. With these actions, we can strive for that position which most American exporters, and certainly The Boeing Company, favor. And this is, the elimination (in cooperation with our competitors) of any competing official export support and its replacement by a flourishing international free market.

In conclusion, it should be noted that EXIMBANK has, in fact, recently developed some innovative programs. They should be congratulated for this - especially the leasing program and the political risk protection program regarding confiscation. The people at EXIMBANK are dedicated, capable and deserve our full support.

Chairman NEAL. Thank you. At this time we will hear from Mr. Robert J. Smith, manager, export sales project financing, General Electric Corp., on behalf of the U.S. Chamber of Commerce.

STATEMENT OF ROBERT J. SMITH, MANAGER, EXPORT SALES PROJECT FINANCING, GENERAL ELECTRIC CORP., ON BEHALF OF THE U.S CHAMBER OF COMMERCE

Mr. SMITH. Thank you, Mr. Chairman, members of the subcommittee.

My name is Robert Smith, manager of export sales projects financing at General Electric in New York City, and I am testifying today on behalf of the U.S. Chamber of Commerce.

I will try to summarize the position taken by the chamber in this document. Of course, it is included in the minutes of the meeting.

We certainly strongly support the renewal of a very strong and active Eximbank. It is needed particularly in today's environment, where opportunities for American exporters are growing in light of the weakening of the dollar around the world, and as well as the cost efficiencies that have been worked into many U.S. businesses.

I would like to read a statement here with respect to General Electric, and that is where I can see in our own company a development very clearly that in a number of cases, our bid prices in response to international tenders, only a few years ago were as much as 50 to 100 percent higher than our foreign competitors. These were embarrassingly high. Even the best financing cannot overcome this kind of a handicap.

But in the last 6 months, we have been very competitive in prices, in notable bids in India and China, and this has primarily been the result of improved productivity at home.

Therefore, what I am saying is we and the other U.S. exporters are now faced with the possibility of many new international bids, a lot of new international business, of certain great assistance to the trade deficit, and for this we need a continued strong Eximbank.

Another consideration that should be given, of course, to the Eximbank rechartering is the fact that in many cases, U.S. businesses have shifted some of their production offshore, to foreign facilities. We want to make sure that this trend does not continue and we do need the assistance of an effective Eximbank in that respect.

Addressing some of the issues in the charter renewal—again, I will try to summarize them. Many of the points have been made by my colleagues from the NFTC and CEE. The competitiveness mandate certainly has to be strengthened. We feel that the Bank has tried in many cases to be competitive. But we feel there are more steps that they can take there.

The reauthorization period for 6 years in order that we don't have to go through these machinations every 2 years is important, as well as the fact that we give assurance to the exporters and to the foreign buyers that there will be an Eximbank available to them.

The Direct Credit Program, which for years has been a well tested and efficient program, has to be maintained. We know that I-MATCH is with us today. It is a very current issue. But we feel

that the Direct Credit Program must be maintained at least in some form and with some funding.

I will come back to I-MATCH at the end and just briefly run through these other issues.

Section 1912, the Matching Credit Program, is something that is very important. It is important to us. We see a number of instances of foreign competitors coming in and competing in the U.S. markets. Recently, we in GE were unable to invoke section 1912 in a case in which Brazil offered financing at 3½ percent for a paper mill in the United States.

This was simply because Brazil was not an OECD signatory. In our opinion, this instance was one that was clearly within the intent of section 1912, but was outside of the interpretation given to it by Eximbank.

With respect to mixed credits, again, a very important issue. The war chest bill that is presently waiting for action should be passed. We do need assistance in mixed credits. We have been pleased with what Eximbank has done in attempting to provide mixed credits in combating certain situations recently.

However, this has to be done consistently and continually. The use of a war chest will be important in this regard.

Some of the issues in the report language that definitely bear discussing are the 2-percent front-end fee. Either this, we feel, should be eliminated or at least, alternatively, financed over the life of the loan and not provide such a heavy burden to the foreign buyer at the beginning of the loan cycle.

Local or host country costs are not funded by Eximbank today. We feel there are many instances where this could be of assistance to us. But even more importantly than host country costs are the inclusion of foreign content in some of our projects, because many times we have been forced in the last few years to source overseas in order to make our total package more price competitive.

I would like to step back for a moment to I-Match.

This was, of course, opposed on many grounds. We do feel that Eximbank has done a commendable job in attempting to address the issues that were of great concern to us last year. They had modified it to make it certainly more responsive to the need of the funding institutions. But there are still a number of issues that we are concerned about, and certainly the new one being the scoring issue that has just surfaced 2 days ago.

One is the efficiency of the program versus the Direct Credit Program. As I mentioned earlier, the Direct Credit Program has been in effect for many years and has been determined to work very efficiently.

We would like to see this maintained.

Second is the subsidy issue. Once the Eximbank reserves are fully utilized, someone is going to have to go back to Congress, presumably for more authorization, and when the word subsidy is bandied around, this to me is going to be an issue of great concern.

We feel definitely that the cost of I-MATCH will be greater than the cost of the Eximbank Direct Loan Program to the U.S. taxpayer, just because of the source of funds that are available to the funding institutions.

As a matter of fact, some banks today—one of the questions is whether or not banks may choose not to participate in I-MATCH.

I think many of them will. I think they have all—most of them have said that they like I-MATCH and the way it is, the way it is now constituted. But I have heard from more than one bank that they would not be willing to quote under the I-MATCH rules because of the need to take such thin margins on U.S. Government-guaranteed paper. And since they are fighting all kinds of regulations and balance sheet improvements in their own area, they had said that they probably would find it very difficult to quote under these regulations.

So to summarize, sir, I believe that I-MATCH is something that could work. We certainly feel that it could work in any particular given case. But we feel that to let an untested I-MATCH be in effect without the funded Direct Credit Program, working simultaneously would be detrimental to the export community in the long run.

That is my statement.

[The prepared statement of Mr. Smith on behalf of the U.S. Chamber of Commerce follows:]

STATEMENT
on
RENEWAL OF THE CHARTER OF THE U.S. EXPORT-IMPORT BANK
before the
SUBCOMMITTEE ON INTERNATIONAL FINANCE, TRADE, AND MONETARY POLICY
of the
HOUSE COMMITTEE ON BANKING, FINANCE, AND URBAN AFFAIRS
for the
U.S. CHAMBER OF COMMERCE
by
ROBERT SMITH
February 20, 1986

Mr. Chairman, members of the Subcommittee, I am Robert Smith, Manager of Export Sales Projects Financing of General Electric (GE) Company in New York City. I am testifying today on behalf of the U.S. Chamber of Commerce.

We strongly support renewal of the Charter of the United States Export-Import Bank (Eximbank). The way in which the bank's charter is renewed may well have a greater impact on U.S. exports than at any time in the past decade. Even though the U.S. trade deficit was almost $150 billion last year, factors are at work that could enhance greatly the importance of the Eximbank as a major partner in the U.S. export effort.

First, for the past year, the overvalued dollar has begun a steady decline against many major currencies, a trend that should help to offset a chief cause of our lack of competitiveness in world markets.

Second, American industry has been undergoing a painful and lengthy period of self-examination, to trim excesses and build the necessary strength to meet foreign competition forcefully. This exercise is beginning to show results, and in combination with improving exchange rates, business is positioning itself for an impressive rebound in the struggle for foreign markets.

I can see this development clearly in a number of cases in which General Electric's bid prices for international tenders only a few years ago were as much as 50% to 100% higher than our foreign competitors. Even the best financing could not overcome that handicap. But in the last six months, we have been very competitive in prices in notable bids in India and China, and this has been a result of productivity improvements at home.

Whether or not the American export sector will reverse or even stabilize its declining world market share will depend essentially on its own efforts. Nevertheless, with basic production costs closer to those of foreign competitors, U.S. exporters will be bidding for more orders, and this will require more export financing support rather than less.

In recent years, some critics of the Eximbank have maintained that the declining demand on its services is proof that it is not needed. The reality is that the demand for the Eximbank's support is a function of overall U.S. international competitiveness and the availability of foreign official export financing.

The outlook in both areas points to increasing demand for the Eximbank's financial support. As the dollar falls and U.S. firms improve their efficiency, foreign governments probably will not resist the temptation to strengthen export financing support for their own exports.

A related consideration in Congressional assessment of the need for the Eximbank's resources is the concern with the transfer of production abroad. In response to the declining competitiveness of U.S.-based production facilities, companies of all sizes have shifted production to

foreign facilities. Again, the ability of firms to reverse this trend will depend on improvements in their competitiveness, including the continued availablity of effective support by the Eximbank.

In supporting the charter renewal for the Eximbank, the Chamber has two types of recommendations: one, those requiring specific authority in the act; and two, those that can be addressed in the report.

I. AMENDMENTS TO CHARTER LANGUAGE

1. Competitiveness Mandate

In the 1983 charter renewal, the Chamber urged the resolution of the conflict between the competitive financing mandate and the bank's goal to be "self-sustaining." The conflict still persists, and the Chamber recommends that rates, terms, and conditions offered be "fully equivalent" to those offered by foreign competitors.

2. Reauthorization Period

The Chamber recommends a renewal term of six years, which would be a practical improvement over the present three-year term. Such a period would provide some assurance of continuity in bank operations, for exporters and foreign customers alike, who occasionally have been in doubt in recent years.

3. Direct Credit Program

The Direct Credit Program, together with the medium-term and small business elements of the direct lending program, is a tested and effective method of financing special categories of U.S. exports. We strongly urge retention of this proven program.

We agree, however, that as long as the current budget treatment of the Eximbank continues, in which dispersements of authorized loans are treated as expenditures -- not loans repaid with interest -- strong pressure to phaseout the direct lending program will persist. The prevailing budget concerns in the Congress preclude radical actions to treat the Eximbank's authorizations in ways that more accurately reflect their actual impact on the federal budget. To move them "off-budget" would be the preferred method. An interim measure that we would support would provide the Eximbank with carry-over budget authority, simply providing that unused portions of funds authorized for a particular fiscal year could be used in succeeding years.

4. I-Match Program

Since its introduction in 1985, the Administration's I-Match proposal has been modified with respect to its technical operating aspects to meet most of the major concerns with the original version raised by the export community. Commendably, the Eximbank's officials have demonstrated their willingness to work with exporters and commercial

banks to develop a workable program. On these grounds, the Chamber joins with other major business organizations in lending its conditional support to the I-Match program; the major condition is that it be operated in conjunction with a funded direct credit program, and not as a complete substitute.

We know that the Direct Credit Program works; we fail to see how the country can risk substituting an untried program before the end of this fiscal year, particularly in view of its higher potential cost to the taxpayer. For instance, we need to hear much more from the commercial banks as to their willingness and ability to participate. Above all, however, we need solid evidence on the budget aspects of I-Match and its true subsidy cost.

5. Section 1912

In Section 1912 of the Export-Import Bank Act, the Matching Credit Program, Congress has responded aggressively to the problem of foreign exporters selling products in the U.S. under export financing terms that violate the Organization for Economic Cooperation and Development's (OECD) limits. In operation, however, the Administration has interpreted the Congressional mandate narrowly and has applied it only in cases in which the signatory to a credit agreement with the U.S. violates the terms of that agreement. This approach leaves U.S. producers vulnerable.

GE recently was unable to invoke Section 1912 in a case in which Brazil offered financing at 3.5% for a paper mill in the U.S., simply

because Brazil was not an OECD signatory. In our opinion, this was clearly within the intent of Section 1912.

A simple amendment to Section 1912 (a)(1) would restore the original intent of the Congressional directive, without impairing the primary export support function of the Eximbank, by establishing that a matching credit would be available when any country violates the OECD guidelines to support a sale within the United States.

6. Mixed Credits

Legislation is pending in the Congress that could strengthen considerably the ability of the United States to respond to the mixed credit practices of foreign countries, most notably the "war chest" bill now awaiting House floor action. In addition, amendments to certain sections of the Tied-Aid/Credit Program, incorporated in the 1983 Eximbank reauthorization, would enhance the U.S. response to mixed credit predatory financing.

Finally, the Chamber supports three proposals for amendment: Section 645(d), which would authorize the Agency for International Development to use non earmarked Economic Support Funds; 646(a)(2), which would allow a majority vote of the National Advisory Council to decide fund use; and 644(a)(1)(b), which would allow offensive and defensive use of tied-aid funds.

II. REPORT LANGUAGE

The Chamber supports other elements of the Eximbank's operations as follows:

The two percent fee should be eliminated. Whether it is regarded as an insurance premium or a bank management fee, the fee is discriminatory against good risks in the former case and too high in the latter. An arrangement similar to the practice in other OECD export finance programs would be more equitable.

Local or host country costs are not funded by the Eximbank. The Chamber supports recommendations that Congress instruct the Eximbank to make local cost funding available on a case-by-case basis.

The Chamber also endorses proposals to have the Eximbank review its policies to allow long-term financing of some foreign content in U.S. exports. Within careful limits, such provisions would enhance the flexibility of U.S. firms to respond to foreign market opportunities and offset the foreign programs that already provide similar coverage for their own exporters.

CONCLUSION

As the terms of international competitiveness begin to improve for American exporters, we can expect that the demand for the Eximbank's support will grow in the years ahead. The renewal of the Eximbank's

charter provides Congress with the opportunity to ensure that the bank is able to respond to the scale and nature of the demands from the export sector of our economy.

Our primary concern is the continued viability of the Direct Credit Program. A longer authorization period for the charter would satisfy the recommendations of the Eximbank, as well as the export sector. Further, strengthening and clarifying the competitiveness mandate, Section 1912, and the mixed credit authority would strengthen the bank's ability to serve as an important partner to business and labor in the effort to boost our export performance.

Mr. Chairman, thank you for your attention. I will be happy to respond to your questions.

Chairman NEAL. Thank you, sir.

I think you all have answered this question, but let me make sure I have it right. If the CBO prevails—if the Congressional Budget Office prevails—and doesn't allow the smoke-and-mirrors approach to this, is it all of your opinions, then, that given the fact that both programs would be scored the same for budget purposes, that the Direct Credit Program is more effective and efficient?

Is there any disagreement with that? I guess that's what I mean.

Mr. Kjellgren.

Mr. KJELLGREN. No. I think certainly our members feel that the Direct Program, under those circumstances, would work better and would have the benefit of having been in place a long time and being understood by all of the people abroad who buy equipment.

Chairman NEAL. Any disagreement?

Mr. NELSON. I wouldn't disagree. I would make one further statement, that if that happens, we would like to see the best features of the I-MATCH II Program then maybe rolled over into Eximbank, such as the financial guarantee issue.

That may be beneficial.

Chairman NEAL. We have still got a problem, and I guess I have a feeling that you all anticipated this problem in all of your work on I-Match. And that is that I couldn't say at this point how much support there's going to be, there would be, within the administration for the Direct Loan Program or the I-MATCH, at what level they would support I-MATCH if it were scored accurately, and I think that's a problem. I think everyone recognizes who follows it that we need a strong Eximbank.

I know in talking about it from time to time with folks who haven't followed it carefully, I would say it's been an ideal Government program. It doesn't compete with private capital. It serves

the national interest, and over the years, it made money. It gets involved when private capital is not available.

So it looks to me like the problem at this point boils down to what kind of support we can get out of the administration for a strong Eximbank. And I don't know what will be forthcoming. I just can't say at this point.

Mr. Leach.

Mr. LEACH. Well, I think we all are in doubt. Frankly, CBO has a logical position and so does OMB. I, personally, am optimistic that given two very logical positions, the Budget Committee will look for an OMB-type solution.

I am very optimistic that I-MATCH will be scored in a sympathetic way. But if it isn't, Chairman Neal has an absolutely valid point that this subcommittee will be competing against other large sectors of the Federal Treasury.

My own sense is that the business community should make a decision on whether or not keeping Direct Loan as the approach will provide adequate resources. And if it makes the decision that you are not going to compete very well with food stamps, with MX missiles, or the agricultural program, then perhaps its major concern is to approach the Budget Committee members with a concerted view to save the Eximbank.

I have reached the conclusion, frankly, that I-MATCH is the best hope at this particular time. Others have differed with that. But I would only suggest that as much as you might favor the Direct Loan Program, if you also reach the conclusion that I-MATCH is not that different, then perhaps you might want to consider a full-court press.

My own estimate is that Eximbank will be in jeopardy unless I-MATCH is scored the right way, that you end up with a definitional problem that has a great deal to do with the future of the bank.

Mr. Pierce.

Mr. PIERCE. Mr. Leach, I wonder, then, if we could conclude that in the category 1 and category 2 countries of the OECD arrangement, the Commonline, and I think, but I can't speak for the nuclear people, that with a clean Exim financial guarantee we could mobilize what is really the emerging trend in the commercial banking and the financial institutions; namely, capital market group formations in various banks. Using the clean Exim guarantee, it could mobilize the capital more efficiently and could save us the use of some direct credit, perhaps quite a bit of direct credit.

As I say, last year, Boeing customers didn't use any direct credits. McDonnell Douglas didn't use any direct credit last year, either, to my knowledge.

Could the sense of this subcommittee be in assisting us to send a message like let's get to market rate, market term and, for the category 3 countries, the Third World countries, which, incidentally, are going to have to be rescheduled under the Baker plan, apply direct credits?

Maybe this is where direct credits would do the most good, because, even with an Exim guarantee in some of those countries, the banks are closed. They have reached the top of their country limits.

Mr. LEACH. Well, I have no personal problem with the extraordinary flexibility. The chairman has been probably the greatest supporter of all approaches of this nature. My own best guess is when push comes to shove, the Budget Committee, if given the option of fully junking I-MATCH, or direct loans, would prefer the first option. It's also possible that OMB will come up with something slightly different than the current I-MATCH approach, which will make it more definitionally acceptable.

But I'm not sure I follow precisely what you have in mind, Jack.

Mr. PIERCE. There are certain impairments to the Exim guarantee at the present time. Although it's the full faith and credit of the United States, there are limitations on the assignability, caps as to interest protection, you have certain other provisions, like who will be paying the fee.

If all those items are cleaned up right now, you could mobilize all sectors of the private capital markets—it could go beyond just the U.S. capital market, which is still the best, hottest, fastest track market there is.

That's what the Europeans are looking at right now through the EC. They are going to clean up their guarantees and get out to pure-cover, because they can't endure the subsidies, either.

We want to be ready. Exim can make money. There would be no subsidization at all.

Now there is the one exception, I will admit, in category 3 countries of the OECD arrangement, as I understand the rate structure. But that's the Third World, the worst part, where rescheduling is almost inevitable the mathematics just aren't there, otherwise.

Maybe that is where whatever limited direct credits are available, should be applied.

Mr. LEACH. I will say this. The most optimistic statement I have heard in the last 3 or 4 years in Congress, came from Mr. Smith. What he said was GE is suddenly in a competitive position around the world.

We all know that the direct loan authorizations were never tapped because we couldn't compete. And so, among other things, you're saying, suddenly, Exim may come under greater pressure from the American exporter.

Mr. SMITH. Absolutely.

Mr. LEACH. The reason they haven't been under demand is that the United States has not been competitive.

It's been 3 years since we have had someone come and say something upbeat as what you just nonchalantly said.

Mr. SMITH. It's been agonizing getting there. [Laughter.]

Mr. LEACH. Now you mentioned as your reason improved productivity.

Is it the value of the dollar?

Mr. SMITH. Well, it's the combination of both. But there has been an awful lot of productivity improvements as well. I'm sure that you'll see the same thing from the other exporters.

Mr. LEACH. Now we know in the last quarter or last year, Boeing had more good news than we have ever heard from your company.

Is that continuing, Jack?

Mr. PIERCE. I would say, from the domestic market, you may see some leveling off. It will be the international markets where the

action is. As you know, 60 percent of our business base is non-United States. It's outside the United States including the Third World. Again, I will give a salute to Exim for working up some innovative ideas on leasing and confiscation risk policy with asset-based financing, which uses the aircraft as security. We can do that for a limited amount, because there's risk-sharing involved.

But, no, there's going to be more action out there in the international market. We have got a major campaign going on in Brazil right now, which is no state secret.

We have been able to stay out of the direct credits—as I say, even with what I call the dirty guarantee or the impaired guarantee. Competitive rates are less. We are talking about 20, 25, 40 basis points improvement, depending on what kind of a structure is available; if you have a clean guarantee.

The objection may be that a clean guarantee is going to create a secondary market. The U.S. Treasury may object.

The trading in the secondary market has been very limited, because they are tying on to the security. It's a good security. If the Europeans are going to move in that direction, anyway, then we are going to have to move out there as well using pure cover, and it should be ideal.

We are going to market term, which gets the subsidies off our back. We are only talking about—let's say at the highest use of the guarantee, Maybe $6, $7, $8 billion. That's peanuts face to face with the huge findings at Fannie Mae, Sallie Mae, Freddie Mac, and others.

Here is where we could get the maximum for your efforts, just by enhancement of the guarantee, going to pure cover and unleashing the capital market—where we have got the advantage in New York, or we use worldwide sources as well.

It's there. We can do it.

Mr. LEACH. I think you have got a good point. It makes more sense when the value of the dollar is in line than when it isn't.

Mr. PIERCE. I am sorry?

Mr. LEACH. It makes more sense in a period when the value of the dollar becomes more constrained.

Mr. PIERCE. Yes.

Mr. LEACH. Partly because it usually relates to what American interest rates are. Therefore, this is a time period where moving in that direction is——

Mr. PIERCE. A great fear should be that in any further rate negotiations between the United States and Europe, official interest rate margins might shrink between the Arrangement rates or the Commonline rate or the nuclear power rate and market rates. Suddenly, a subsidy would creep back in again if this occurred.

So the most important thing is to keep those margins with a sufficient spread that we can come in underneath and with pure cover, just using the guarantee in the private capital market, reduce the financing costs for all.

If anything, they ought to be bumped up a little bit higher since all rates have dropped worldwide. It's time to lift that margin up a little bit more and then assure that we never go back into subsidization.

That's where I would concentrate your attention.

Mr. LEACH. I think you have made a great case. All I would suggest is that in moving in that direction, that we may become very vulnerable to the whims of one decision made by the Budget Committee. That being the case, I would really strongly advise some lobbying of key Members on that committee.

I mean, we are no longer, on this one decision, the crucial decisionmaking committee.

I have no further questions, Mr. Chairman.

Chairman NEAL. Thank you. Mr. Chandler.

Mr. CHANDLER. Thank you, Mr. Chairman.

Just to follow on Mr. Leach's comment, and like you said, it may not have anything to do with decisions, but I look at this, and correct me if I'm wrong, there is a difference between the following three concepts—one of a direct expenditure by the Government, salaries of air traffic controllers, for example, getting salary in the form of taxes—if you pay him, you don't ever expect to see that. He provides you with a service. Then a direct loan of some agency of the Government. If you go into capital markets, you borrow it. You lend it and you expect to get it back. That's the second.

The third, a guarantee is yet another concept where you may or may not have any ultimate liability as a guarantor. And the three are very radically different. You would carry it differently on your books.

Mr. PIERCE. When using the Exim guarantee, no bank extends money under the assumption that they're going to have to call on a guarantee. If they do, they are making it for the wrong reason.

Mr. CHANDLER. Sure.

Mr. PIERCE. And I have seen it happen. In certain LDC countries, even where the Exim guarantee is available, banks can hit the country limit. They say: "Sorry, we just can't take any more of that country."

But with the Exim guarantee, essentially what occurs is that Exim is paid to add sovereign risk to what is otherwise totally private capital mobilization and—mobilization of the best sectors of the capital market, no matter where they rest in the world.

In other words, we might tap the yen market one day, dollars, Libor, whatever, the next. It's that capability, of the moving across the world capital market, that comes with a clean guarantee. It's the best of all worlds.

Mr. CHANDLER. Now when you mention Brazil, Yugoslavia, Mexico, and I think Venezuela——

Mr. PIERCE. Venezuela.

Mr. CHANDLER [continuing]. And those are markets that you are working currently.

Mr. PIERCE. Well, we have gotten around the problem. There are 50 banks in our syndicate. The reason I mentioned that here is, the small exporter doesn't have that capability.

Mr. CHANDLER. Sure. But my question, though, is the problem there the need for the guarantee or competition in subsidy from your competition.

Mr. PIERCE. No.

Mr. CHANDLER. Or both?

Mr. PIERCE. In the current Commonline agreement for financing aircraft, there is a sufficient margin, which is about 120 basis point

spread over Government cost; I won't go into the multicurrency formula that Airbus has. But by using even the dirty Exim guarantee, last year, we managed just to come in underneath, or on the button with, the aircraft Commonline rate.

In the case of Yugoslavia, they had a choice. They could have taken direct credit. But, we said, maybe you will want to take a float or a cap or rollout later and do an interest-rate swap, and that's exactly what they did.

So the customer stayed flexible, stayed with the guarantee. In a falling interest rate environment, at or below the arrangement rate, if you are a smart bettor, you will probably stay with the guarantee and float down for a while and then fix the rate later, closing off your liability with a known rate.

Mr. CHANDLER. Yes.

Mr. PIERCE. So all I am saying is, with a good guarantee, one that is very clean, very effective, you can be pulling in pension funds, insurance companies, the whole of the capital markets to finance exports.

Mr. KJELLGREN. I would just like to support what Jack has said. As a banker, as a representative of one of the banks that's in this business, we are very much interested in seeing the business expand. We think the markets can take care of these needs, in category 1 and 2 countries.

Mr. CHANDLER. In the case of a country like Peru, they are flying old DC-8's. I think they only have one government airline. It looks like a great market for 737's and 300's, and so forth. Is anybody going to loan any money even with guarantees in a situation like that?

Mr. PIERCE. Well, this only applies in mobile assets, like airplanes, locomotives, oil drilling equipment, and others where, if there is confiscation risk the aircraft, for example, itself is the primary security and in the event of default, the lender repossesses the aircraft. The private political risk market on repossession is limited to a maximum of 3 years.

Exim has very imaginatively come in with some confiscation risk revision, even coming in as a coinsurer to stabilize in that capacity to the Lloyd's reinsurance market. As a private corporation, it's a contingent liability to avoid.

In certain cases, Exim says, the door is closed because we are about to anticipate a rescheduling. Well, if it's going to come, the rescheduling will come. Secretary Baker anticipates some rescheduling. So why not all get together and use our trade credit as one of the primary ways to extend additional credit. Whether we do it or we don't, the Europeans are. They're packing up their trade credits as the top priority of rescheduling items. We should be equally prepared.

Mr. CHANDLER. Mr. Kjellgren.

Mr. KJELLGREN. Could I go back to one thing that you said at the beginning where you were mentioning the three different kinds of Federal expenditure and the fact that they were quite different? It seems to me that the I-MATCH Program really falls under the third one.

Mr. CHANDLER. That is correct.

Mr. KJELLGREN. That is, they are utilizing the guarantee of the Export-Import Bank, which is currently authorized, I think, or proposed for $12 billion, and there has been, as far as I know, no pressure on that budget item.

I am very puzzled as to why the CBO then says that in addition to that, for the same transaction, they have got to charge direct credits, $1.8 billion, when the Eximbank is not going to disburse that money from its own funds.

I mean, I've heard it said here that the CBO has a logical position, but I guess I don't understand that position.

Mr. PIERCE. Well, my understanding is that under the circular 70-A, unless there is risk-sharing by the private party, to the extent of 20 percent, it does, in fact, get into a unified budget. I question the feasibility of exporters taking 20 percent of the risk. We would lose out competitively.

Who under the funds, when and for how long figures in their thinking somehow. It's a blockade to innovation.

Mr. CHANDLER. If I could just have one more very brief one.

Chairman NEAL. Sure.

Mr. CHANDLER. Mr. Smith, you mentioned that without Exim direct credits, or with the continuation of Exim direct credits, you thought that there would be a tendency, or less of a tendency for U.S. manufacturers to move operations offshore. I certainly agree with you when you say that we want to avoid that.

I'm just curious how that—what's the relationship between the two?

Mr. SMITH. Well, I think—that statement may be a little out of line here—but I feel it's probably more because of the weakening of the dollar, making us more price competitive will stop us from moving things offshore. But we still need the Exim support.

Mr. CHANDLER. Thank you, Mr. Chairman.

Chairman NEAL. Yes. Mr. Parris.

Mr. PARRIS. Mr. Chairman, I apologize for being late to the hearing. I came from another hearing in a separate committee.

My only purpose in coming was to get up to speed, I hope, on the budget accounting on the I-MATCH Program. I would not extend this hearing in all my life.

Thank you very much. [Laughter.]

Chairman NEAL. CBO will be testifying here very soon on that, of course. Well, let me thank our distinguished panel of witnesses today for your help. We welcome your advice as we proceed.

The subcommittee will stand adjourned until Tuesday the 25th for our next scheduled hearing.

[Whereupon, at 11:10 a.m., the subcommittee adjourned, subject to the call of the Chair.]

THE CHARTER RENEWAL OF THE EXPORT-IMPORT BANK

TUESDAY, FEBRUARY 25, 1986

HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON INTERNATIONAL FINANCE,
TRADE AND MONETARY POLICY,
COMMITTEE ON BANKING, FINANCE AND URBAN AFFAIRS,
Washington, DC.

The subcommittee met at 10:10 a.m. in room 2220 of the Rayburn House Office Building, Hon. Stephen L. Neal (chairman of the subcommittee) presiding.

Present: Chairman Neal; Representatives Kleczka and Leach.

Chairman NEAL. I will call the subcommittee to order.

This morning we begin our third day of hearings on the administration's legislative proposals for the reauthorization of the Export-Import Bank and the establishment of the so-called I-MATCH Program.

We are pleased to have four distinguished witnesses on our panel today: Ms. Laura Goldhar, vice president of Chase Manhattan Bank; Alex Velden, director of Johnson & Johnson's export division, on behalf of the Emergency Committee for American Trade; Miner Warner, vice president of Salomon Bros.; and Larry Williams, vice president of marketing for Caterpillar Tractor Co.

The subcommittee has asked these witnesses to address two subjects: One, the pros and cons of the I-MATCH proposal from their perspectives as representatives of exporting companies or financial institutions that finance exports; and, two, any recommendations regarding ways to improve the Export-Import Bank Act.

On Thursday we will hear testimony from the Congressional Budget Office on their analysis of I-MATCH's budgetary impact. I understand that CBO has decided that it will score I-MATCH the same as it scores direct loans; therefore, instead of yielding a bookkeeping reduction in the budget deficit as originally touted by the administration, I-MATCH would add more to the budget deficit than the Direct Loan Program. This is because the budget authority and outlays of I-MATCH would be somewhat higher than for direct loans.

If this interpretation of I-MATCH's budgetary impact is accepted by the Budget Committee, the rationale for I-MATCH would disappear. Thus, there would be no reason for us to act on the I-MATCH proposal as part of Exim's reauthorization. I hope that this situation will be clarified by our hearing on Thursday.

Since there are no other opening statements, we will now hear from our witnesses. I would ask, without objection, that we put the entire statements in the record, and hearing none, that will be done.

I would urge our witnesses to summarize as much as they can without reducing any of the meat of their testimony so that we might have the time for questions and answers.

Ms. Goldhar, would you like to begin at this time?

STATEMENT OF LAURA GOLDHAR, VICE PRESIDENT, CHASE MANHATTAN BANK

Ms. GOLDHAR. Good morning, Mr. Chairman. I am Laura Goldhar, vice president of the Chase Manhattan Bank. I am pleased to have this opportunity to testify on the medium-term portion of the proposed I-MATCH II programs.

My experience with Eximbank dates back to 1968. Currently, I am with the Government agency unit of Chase's U.S. Trade and Export Finance Division. I am primarily responsible for product development, marketing support, and portfolio management related to Eximbank programs.

Before I turn to the I-MATCH Program, I would like to mention the two types of support which Eximbank provides for medium-term exports.

One is risk protection, covering risk of nonpayment by an overseas buyer. The other is funding, which is provided on a fixed rate basis at the OECD consensus rates.

Today Eximbank's medium term risk protection is provided through its commercial bank guarantee programs and through the programs offered by its insurance affiliate, the Foreign Credit Insurance Association.

Medium-term funding is currently provided through Eximbank's medium term and small business credit programs. It is these programs that I-MATCH II would replace.

Under the current funding programs for eligible transactions, Eximbank provides matching medium-term fixed rate funding to commercial banks for the loans we make to overseas buyers. This funding may be accessed to loans or any combination of Eximbank's risk protection programs.

We believe that in order to be effective, it is essential that I-MATCH II or any other medium-term program must:

One, assure continued availability of competitive medium-term fixed rate consensus financing.

Two, encourage active bank participation and support.

Three, be accessible, understandable, and operationally uncomplicated.

And, four, offer an assured level of consistent Federal Government support.

First, I mentioned access to competitive fixed rate financing. Today, Eximbank's medium term funding programs are the only programs which offer U.S. exporters access to competitive fixed rate support for their sales of capital goods and services on repayment terms of 1 to 5 years.

Since foreign governments routinely provide their exporters with this support, these funding programs are critical if U.S. exporters are to effectively compete in world markets.

Prior to its 1983 charter renewal, Eximbank provided funding support for only 65 percent of the contract value. This level made it not only difficult for U.S. exporters to compete with their foreign suppliers, who could get 85 percent funding, but also proved operationally cumbersome. This was especially true when the funding support was combined with Eximbank's risk protection support, which was available for up to 85 percent of the contract value.

Under this earlier system there were potentially three separate financing transactions. Up to three promissory notes had to be negotiated with the foreign buyer, each reflecting different interest rates and terms, depending on what Eximbank funding and guarantee support was available. As a result of these cumbersome transactions, many banks discontinued their participation in the Bank's program.

In 1983, the system was changed. Eximbank now provides funding support for up to 85 percent of the contract value. This not only makes the program competitive with foreign export credit agencies, but also eased the operational burden.

Today, Eximbank provides advanced commitments assuring availability of fixed rate support both during the bidding period, which may last 6 months or longer, and throughout the loan's repayment term. The uncertain availability of the private market of fixed rate funding sources at a date that may be months or years in the future would not permit commercial lenders to commit themselves to supply fixed rate funds of any type without substantial penalty costs.

The availability of competitive medium term consensus rate financing is essential, and I-MATCH II or any other medium term program should be structured to maintain the competitive aspects of the current program. These include access to medium term fixed rate funding, funding for up to 85 percent of the contract value, availability of advanced commitments and the ability to obtain either funding only or funding and guarantee support.

I-MATCH II must also encourage active bank participation and support under their current programs.

In the I-MATCH II proposal commercial banks are the sole source available for U.S. exporters to access Eximbank's medium term funding and guarantee programs.

It is critical to both Eximbank and the exporting community that commercial banks continue to participate actively in these programs. Despite the 1983 improvement, only 60 banks now participate in the Eximbank's medium term funding programs and only a third of these banks were involved in more than one transaction.

A slightly larger number, 93 banks, participate in the medium term guarantee program. This is less than one-half of 1 percent of the nearly 14,000 commercial banks operating in this country.

Commercial banks are under increasing management and shareholder pressure to justify each product's profitability. The investment necessary to maintain their program knowledge, provide internal training, offer customer and financing support, develop doc-

umentation, monitor loan operations, and manage portfolios is high.

This investment may not be justified by the size. Typically, medium term transactions range from $50,000 to $1 million, or the earnings related to such transactions.

Further, banks must consider the long leadtime required in export transactions and the low ratio, currently 1 in 30 or lower, of transactions completed to transactions begun. Many banks will likely conclude that they can no longer afford to support these programs. For others the business will be marginal at best.

Another factor affecting bank participation in I-MATCH II is the basis on which the proposed interest makeup will be determined. I-MATCH II provides for Eximbank to base its interest rate makeup on a benchmark rate; for example, certificates of deposit, which are adjusted each 6 months.

The majority of commercial banks cannot rely on a consistently available pool of medium term fixed rate funds and will be funding those loans from short-term sources ranging from overnight to 6 months.

We recommend that Eximbank consider allowing banks a selection from among a variety of benchmark options. This would allow banks to more closely match the benchmark rate to their actual funding sources, and increased bank participation would be encouraged.

A third factor that will affect the level of bank participation will be the availability of secondary market liquidity for loans created under this program. I-MATCH II would allow the originating bank to sell the loans to the Private Export Funding Corporation [PEFCO], or to another investor so long as the originating bank continued to service the loan.

However, loans sold to PEFCO will be limited to those which also carry Eximbank's risk protection guarantee, while loans sold to other investors, whether guaranteed or not, would lose the benefits of Eximbank's interest makeup.

To assure adequate liquidity, we recommend that Eximbank adopt a flexible approach to the transferability of funds, particularly between banks, and a broad definition of eligible secondary market investors, including not only banks and PEFCO but also exporting companies, investment banks, and nonbank financial institutions.

Returning to my list of overall criteria for effectiveness, the program must be accessible and understandable.

Currently, while the medium term risk protection and funding programs are often combined in one transaction, they have differing eligibility criteria and operating requirements. Banks that have attempted to combine the use of these programs have found that to be complicated and operationally cumbersome. Indeed, some banks have characterized these programs as "an administrative nightmare."

Exporters, too, are confused by the various program requirements and have been discouraged in their use of Eximbank programs. They often cite the detailed program definitions, the lack of flexibility to accommodate specific transaction structures, the time and information required to obtain a commitment of Eximbank

support, and the difficulty in determining which programs best meet their needs.

I-MATCH II must assure exporters that they will continue to be able to access this important source of competitive fixed rate financing, that the fees charged under this program will be competitive with those charged by Eximbank under its long-term program and that Eximbank will remain flexible in its determinations that there is adequate evidence of foreign government supported competition.

Finally, given the long leadtime involved in export transactions, exporters need to know that Eximbank support will be available, not only this year but in the future.

Renewal of Eximbank's charter through 1991, with adequate budget authority, would send a much needed message to the U.S. exporting community.

In conclusion, Eximbank's medium-term funding programs are the only source of medium-term fixed rate financing that is competitive with that available to foreign suppliers. At a time when U.S. exporters are becoming more price competitive and are struggling to regain lost market share, Eximbank must be able to assure the availability of such financing either through the continuation and improvement of the current programs or through an effectively structured I-MATCH II replacement.

Thank you for this opportunity to give a banker's view of the current programs.

[The prepared statement of Ms. Goldhar on behalf of the Chase Manhattan Bank follows:]

STATEMENT OF
LAURA GOLDHAR
VICE PRESIDENT
THE CHASE MANHATTAN BANK, N.A.

I am Laura Goldhar, Vice President of the Chase Manhattan Bank. I am pleased to have this opportunity to testify before this subcommittee on the medium term portion of the proposed Eximbank I-Match II programs.

My experience in working with the programs of the Export-Import Bank dates back to 1968 and includes working as a loan officer at Eximbank, and as an export finance and marketing officer for a regional bank and in an Edge act subsidiary. Currently, I am an officer in the U.S. Government Agency Finance unit of Chase's U.S. Trade and Export Finance Division, where I am primarily responsible for product development, marketing support and portfolio management related to Eximbank programs.

The Chase Manhattan Bank has had a long relationship with Eximbank, dating back to the 1940's. Chase has been an active and consistent participant in Eximbank's medium-term programs since their inception in the early 1960's.

During that period, Chase has consistently invested in developing and maintaining a high level of expertise in these programs. Today, our current staff combines over 80 person- years of experience in Eximbank programs and represents a substantial investment of the bank's resources.

Chase's longstanding support for U.S. exports reflects our belief in a strong, free and fair trade economy and our desire to meet the needs of our exporting and importing client base.

Eximbank's programs have played a key role in our ability to meet these needs. At a time of increasing concern about multinational banks' cross border exposures, the protection afforded by Eximbank's guarantee and insurance programs has allowed us to offer our exporting customers continued support.

Before I turn specifically to the I-Match program, I'd like to discuss the current support which Eximbank provides for medium-term exports in order to provide an appropriate perspective. Today, Eximbank offers two distinctive types of support. One is Risk Protection, covering the risk of non-payment by an overseas buyer. The other is Funding, which is provided on a fixed-rate basis at the applicable OECD "Consensus" rates. These Consensus rates are the minimum interest rates under the OECD Arrangement applicable to loans supported by export credit agencies.

Today, Eximbank's medium term risk protection is provided through its commercial bank guarantee programs, and by the exporter and bank insurance policies offered by its insurance affiliate, the Foreign Credit Insurance Association. Medium-term funding is currently provided through Eximbank's Medium Term and Small Business Credit programs. It is these latter two programs which the medium-term I-Match program proposes to replace. Under these current funding programs, if foreign competition is proven, Eximbank provides matching medium-term, fixed-rate funding to commercial banks for the loans we make to overseas buyers at Consensus rates.

We believe that, in order to be effective, it is essential that I-Match II, or any other medium term program proposal, must:

- o Assure continued availability of competitive medium-term fixed Consensus rate financing

- o Encourage active bank participation and support

- o Be accessible, understandable and operationally uncomplicated

- o Offer an assured level of consistent Federal government support

First, I mentioned access to competitive fixed-rate financing at OECD Consensus rates. Today, Eximbank's medium-term funding programs (the Small Business and Medium Term Credit) are the only programs which offer U.S. exporters access to competitive fixed Consensus rate support for exports of capital goods with repayment terms of 1 to 5 years (and on an exceptional basis for longer periods). Since foreign governments routinely provide their exporters with medium-term fixed Consensus rate support, these funding programs, as a source of such financing, are critical in order to allow U.S. exporters to effectively compete in world markets.

Indeed, much of the competitiveness of these programs resulted from the legislative mandate adopted by this subcommittee in

Eximbank's 1983 charter renewal, which led to an increase in the percentage of Eximbank's funding support available under these programs. Prior to 1983, Eximbank's funding support was limited to only 65% of the U.S. contract value. This limited level of support not only made it difficult for U.S. exporters to compete with foreign suppliers who could access 85% funding support, but also proved operationally cumbersome for overseas buyers and the financing banks.

Let me give you an example. In a typical transaction, under this earlier system, there were potentially three separate but related financing transactions; (1) the required 15% down payment by the foreign buyer which might be - and frequently was - financed by the commercial bank on a floating rate basis without any Eximbank support; (2) the 65% fixed Consensus rate financing provided by the commercial bank with Eximbank's funding support; and (3) the remaining 20% financing provided by the commercial bank on floating rate terms without Eximbank support. This structure meant that exporters and their commercial banks would have to negotiate up to three separate promissory notes with the foreign buyer, each reflecting different terms and conditions. A further complication for commercial banks financing such transactions was that while Eximbank provided only 65% funding support, it continued to provide guarantee and insurance support for up to 85% of the U.S. contract value. As a result of the cumbersome nature of these transactions, many banks discontinued their participation in the funding program.

In 1983, the system was changed so that Eximbank now provides fixed Consensus rate funding support for up to 85% of the U.S. contract value. This change not only made the program more competitive for U.S. exporters, but also eased the operational burden for their bankers. For eligible transactions, banks can now obtain funding for the full 85% financed amount, eliminating the multiple promissory note scenario; and exporters, facing foreign government-supported competition, can offer to arrange for their customers competitive fixed Consensus rate financing.

Thus, U.S. exporters facing foreign government supported competition now have the ability to tap an important and otherwise unavailable source of competitive medium-term fixed Consensus rate financing. In the absence of Eximbank's funding support, such financing would not be available from the private market today.

Under the current funding programs, Eximbank provides advance commitments, assuring the availability of Eximbank's fixed rate support both during the bidding period (which may last six months or longer) and throughout the full repayment term of the resulting loan, which may be five years or longer. The uncertain availability in the private market of fixed rate funding sources at a future date (particularly a date months or years in the future) would not permit commercial lenders to commit themselves to supply fixed rate funds of any type without substantial penalty costs.

It is essential to ensure the availability of competitive medium term Consensus rate financing; and I-Match II or any other medium term program, should be structured to fulfill this need. Specifically, the competitive aspects of the current program must be maintained. These currently include access to competitive medium term fixed consensus rate funding; funding for up to 85% of the U.S. contract value; the availability of advance commitments; and the ability to obtain funding only or funding and guarantee support.

The second important criterion of overall effectiveness is to ensure active bank participation and support. Under both the current programs and the proposed I-Match II programs, commercial banks are expected to be the sole source available for U.S. exporters to access Eximbank's medium term funding and guarantee programs. As a result, it is critical to both Eximbank and the exporting community to ensure that commercial banks continue to participate actively in these programs.

Despite the 1983 program improvements, only 60 banks currently participate in Eximbank's medium term funding programs and only a third of these banks were involved in more than one transaction. Further, only a slightly larger number (93) participate in the medium term guarantee program. This is less than 1/2 of 1% of the nearly 14,000 commercial banks operating in this country.

As competition in the global financial services industry becomes more intense, and more non-bank players enter the arena with new services and capabilities, commercial banks are under increasing management and shareholder pressure to justify their product profitability. As more banks go through this process, they will be forced to consider the level of investment necessary to maintain their program knowledge, provide internal training, offer customer marketing and financing support, develop documentation, monitor loan operations, and manage their portfolios. For example, on the training side, because there are so many factors involved in structuring and documenting specific transactions, it takes years to build genuine competency in this field.

As a result, banks must make a continuing investment to maintain the necessary level of expertise to deal with these programs - an investment which may not be justified by the size (typically medium term transactions range from $50,000 to $1 million) or earnings related to such transactions.

Further, banks must place such investment in the context of the long lead time required in export transactions and the low ratio--currently 1-in-30 or lower--of transactions completed to transactions begun. It is unfortunately likely that many banks will conclude that they can no longer afford to support these programs. For many the business will be marginal at best.

Already, we are aware that several active users of Eximbank's programs (including both regional and money center banks) have opted out of this business.

The problem becomes more obvious if we add in the cost of non-transaction related expenses such as participating in internal and external meetings to recommend program changes, review new program proposals, respond to program surveys and the like. To give you an example, in the 32 business days since I-Match II was announced, I personally have spent the equivalent of 10 business days (including preparing this testimony) working on I-Match II. If I had been available to the bank to work on a financial advisory contract, this same amount of time would have contributed $10,000 to the bank's fee income.

A second critical factor for banks in assessing their participation in I-Match II is the basis on which the proposed interest make-up will be determined. In an important change from I-Match I, the proposed I-Match II program now provides for Eximbank to base its interest rate make-up on a benchmark (e.g. Certificates of Deposit), which is adjusted each six months. This is particularly important for the majority of commercial banks, which cannot rely on a consistently available pool of medium term fixed rate funds. Instead, these banks would be funding medium term fixed rate loans from short term funding sources, ranging from overnight to six months.

To the extent that banks actually access funds at the benchmark rate, they would obtain the same return under I-Match II as under the current funding program. However, since regional and foreign banks typically rely on higher cost sources of funds, they would receive a lower return than under the current program.

We would recommend, therefore, that Eximbank consider allowing banks a one-time upfront selection from among a variety of benchmark short-term rate based options. This would allow banks to more closely match the benchmark rate to their actual funding sources. Further, by assuring that banks actually receive their expected return (assuming such return is acceptable given the level of investment noted above) increased bank participation would be encouraged.

A third factor that will affect the level of bank participation will be the availability of secondary market liquidity for loans created under this program. As currently proposed by I-Match II, the originating bank could sell the loans to the Private Export Funding Corporation (PEFCO) or to another investor, so long as the originating bank continued to service the loan.

However, there are limitations on this secondary market transferability. Loans sold to Pefco would be limited to those which also carry Eximbank's risk protection guarantee; while

loans sold other investors, whether guaranteed or not guaranteed, would lose the benefits of Eximbank's interest make-up.

To assure banks of adequate liquidity, we recommend that Eximbank adopt a flexible approach to the transferability of loans, particularly between banks, and a broad definition of eligible secondary market investors which would not only include banks and Pefco but also exporting companies, investment banks, and non-bank financial institutions.

Returning to my list of overall criteria for effectiveness, the third element was the need to make the program accessible and understandable. Commercial banks encounter serious problems in dealing with the myriad of program details and definitions. While both the medium term risk protection and funding programs are often combined in one transaction, they have differing eligibility criteria and operating requirements. Banks that have attempted to combine the use of these medium term programs, have found them to be complicated and operationally cumbersome. Indeed, some banks have characterized the programs as an "administrative nightmare".

Exporters too are confused by the various program requirements. As a result, they have been discouraged in their use of Eximbank programs. Often cited reasons for their lack of participation are the detailed program definitions, lack of flexibility to accommodate specific transaction structures, the

time and amount of information required to obtain a commitment of Eximbank support, and the difficulty in determining which of the various programs best meet their needs.

The proposed medium term I-Match programs, or any other medium term program, must assure exporters that they will continue to be able to access this important source of competitive fixed rate financing; that the fees charged under this program be competitive with those charged by Eximbank under its long term program (the medium term fee structure is more costly than that of Eximbank's long term program); and that Eximbank will remain flexibile in its determinations that there is adequate evidence of foreign competition.

The final criterion mentioned was the assurance of a consistent level of federal government support. Given the long lead time involved in export transactions, U.S. exporters need to be assured that Eximbank support will be available not only this year but in future years. This requires a continuing commitment by the United States government to ensure that the assistance provided by Eximbank in support of U.S. exports is continued and remains competitive with that offered by other foreign government supported export credit agencies.

Renewal of Eximbank's charter through 1991 would provide a much needed message to the U.S. exporting community that Eximbank support will remain available.

In addition, U.S. exporters need to be assured that there will be adequate budgetary authority to support the current programs, or their I-Match II replacements. The impact of inadequate budgetary authority has already been noted above. It was as a result of the lack of such budgetary authority that Eximbank cut its medium term funding support to 65%, thereby reducing the competitiveness of U.S. exporters and increasing the operational burden on program participants.

In conclusion, Eximbank's medium term funding programs are the only source of medium term fixed rate financing in an amount and at a rate that is competitive with that available to foreign suppliers. At a time when U.S. exporters are becoming more price competitive and are struggling to regain lost market share, it is increasingly important that these programs be continued.

Eximbank must have the authority and resources to assure the availability of such financing either through the continuation and improvement of the current programs or through an effectively structured I-Match II replacement.

Chairman NEAL. Thank you very much. Your testimony is certainly very useful to us. We appreciate it.

Mr. Velden, we would like to hear from you, please.

STATEMENT OF AXEL O. VELDEN, DIRECTOR, JOHNSON & JOHNSON EXPORT DIVISION, ON BEHALF OF THE EMERGENCY COMMITTEE FOR AMERICAN TRADE

Mr. VELDEN. Mr. Chairman, thank you for the opportunity to appear before you today on behalf of the Emergency Committee for American Trade [ECAT] in connection with Eximbank's reauthorization legislation.

My name is Axel O. Velden, director of the Johnson & Johnson International export division.

ECAT supports a strong Export-Import Bank that will be able to continue its role of financing U.S. exports. Without Eximbank a number of ECAT members would have lost many billions of dollars in export sales over recent years. We are concerned that sales may be lost in future years if adequate lending authority for the Bank is not maintained.

Consequently, ECAT supports a 6-year extension of the Eximbank charter, through September 30, 1992, to assure that its programs will continue to be available for U.S. exporters.

Last year's foreign trade deficit of nearly $150 billion is frightening. The 1986 deficit is expected to be even larger. Cutting out funding for Eximbank lending authority, as proposed in the President's fiscal year 1987 budget, is not advisable. Our exports will suffer, and jobs may be placed at risk.

ECAT urges the Congress to continue to support the direct credit program at its current authorized level of $1.1 billion.

American business is under seige from very effective foreign competitors, many of whom are subsidized by their governments. The U.S. share of world markets is barely holding its own.

We are doing what we can to increase our trading capabilities as much as possible; however, we can use any help we can get from our government to meet the many foreign competitive challenges facing the American business community.

ECAT has some concerns about the administration's proposal to establish an interest matching program in place of a direct lending program.

If the necessary funds to match the difference between the commercially available domestic interest rates and the foreign interest rates come from the Bank's reserves, we are concerned about the effect on future budgeting for the Bank.

Another consideration is the cost of the program. Some estimates place the cost considerably higher than that of the Bank's loan operations. There is also the possibility that the I-MATCH Program will not be able to generate the necessary financing to meet an Eximbank commitment. Such a contingency could be handled if backup authority for direct loans remained intact.

ECAT believes that I-MATCH should first be given a trial run as a supplement to the direct credit program instead of replacing it.

When we testified on the Eximbank before the Senate Banking Committee on February 7, we strongly recommended, as we also

are today, that the direct lending authorities of the Eximbank be retained and that an interest matching program be experimented with but not as a substitute for direct loans.

The recent indication of the Congressional Budget Office that the proposed interest subsidization program would have to show as a budget expenditure, as would any direct loans, strengthens our belief that a direct lending authority of at least $1.1 billion is necessary to assist vitally needed U.S. exports.

I would like to comment also briefly on Eximbank's role in mixed credits.

From ECAT's perspective, it is essential that the Bank have the resources to combat the mixed credit practices of foreign governments. Enactment into law of the war chest proposal, an issue on which your committee has been in the forefront, will play a vital role in this task.

The recent experience of Johnson & Johnson International illustrates the need for a strong mixed credit program.

In 1985, we were successful in securing a $44 million order for hospital equipment destined for a number of hospitals in the State of Sao Paulo, Brazil. Johnson & Johnson coordinated this project and obtained the participation of approximately 40 different U.S. equipment manufacturers in putting together the final order. This project could not have gone forward without support from the Eximbank.

The French have targeted the hospital equipment market in Brazil, and they captured leadership. This was accomplished exclusively through mixed credit umbrella agreements negotiated annually since 1982.

Our customers informed us that the French manufacturer was bidding for the same business, offering extremely concessionary terms, including 2-percent interest on a part of the costs and also extended payment terms.

Our only chance was to persuade Eximbank to match the French financing package as closely as possible. The Bank did so, and the U.S. consortium has now entered into final contract negotiations.

This result was critically important to us and to the other suppliers, because of the nature of the equipment involved. The vast majority of items destined for Brazil in this package consisted of state-of-the-art diagnostic equipment, including magnetic resonance imaging.

Johnson & Johnson is a leader in this technology, having obtained FDA approval in 1984, and these items represent millions of dollars in research and development costs that cannot be recovered in U.S. sales alone.

Mr. Chairman, we realized that U.S. efforts to counteract foreign mixed credit competition have only been partially successful. Japan, West Germany, and France have not shown a willingness to abandon the practice, and they continue to siphon off attractive American export opportunities around the world through financing concessions.

Resources to combat interest subsidies are scarce and are likely to become completely unavailable in the present cost-cutting climate. Nevertheless, we are gratified that Eximbank saw the Brazilian market situation as one that required aggressive action. We

hope that the Bank will continue to show a willingness to battle mixed credits around the world. We would not be able to regain this lost market without an institution like Eximbank that has U.S. exports as its primary mission. We understand the hard choices Congress must make in the present budget situation, but we also see tremendous potential for exporting the products of our medical technology, if we can discourage foreign competitors from tipping the scales with government subsidies.

Medical technology offers unique opportunity for export growth, because it is among the last areas in which the United States enjoys world leadership. Our competitors realize this, because otherwise they would not perceive a need to offer major financing concessions. They do so, because on even terms, they know we would beat them every time.

Mr. Chairman, we urge Congress to renew the authority of the Eximbank for 6 years, to maintain Eximbank's mandate for direct credits at the current authorized level of $1.1 billion, to allow a trial run for the I-MATCH Program, and within limits prescribed by the deficit situation, to continue to encourage Eximbank's active participation in fighting off mixed credits.

Only if the financial playing field is even, can Johnson & Johnson and the other ECAT companies maintain a strong presence in the world markets, of which they are truly capable.

[The prepared statement of Mr. Velden on behalf of the Emergency Committee for American Trade [ECAT] follows:]

Emergency Committee for American Trade

STATEMENT OF AXEL O. VELDEN,
DIRECTOR, JOHNSON & JOHNSON EXPORT DIVISION,
ON BEHALF OF THE EMERGENCY COMMITTEE FOR AMERICAN TRADE
BEFORE THE
SUBCOMMITTEE ON INTERNATIONAL FINANCE, TRADE AND MONETARY POLICY
OF THE
COMMITTEE ON BANKING, FINANCE AND URBAN AFFAIRS
ON THE
THE EXPORT-IMPORT BANK REAUTHORIZATION
February 25, 1985

Mr. Chairman and members of the Committee, I am Axel O. Velden, Director of the Johnson & Johnson Export Division, and I am appearing on behalf of the Emergency Committee for American Trade (ECAT). Johnson & Johnson is a diversified health care products manufacturer with annual worldwide sales of approximately $6 billion. We exported approximately $50 million in volume last year and together with the other ECAT members have a keen interest in the Export-Import Bank.

ECAT is an organization of the leaders of 62 large U.S. business firms with extensive overseas business interests. ECAT member companies had 1985 worldwide sales of approximately $700 billion and employed over five million people. ECAT's purpose is to advocate and support policies that will expand U.S. international commerce.

We appreciate the opportunity to appear before you and express our support for a viable Export-Import Bank that will be able to continue its valued and historic role of financing U.S. exports. Without the lending and other facilities of the Eximbank, a number of ECAT member companies would very likely have lost many billions of dollars of export sales over recent years. We are concerned that many billions of dollars of prospective export sales may be lost in future years without an adequate lending authority for the Eximbank. ECAT

supports a six-year extension of the Eximbank Charter through September 30, 1992, to ensure that the programs of the Eximbank continue to be available for U.S. exporters.

Last year's foreign trade deficit of nearly $150 billion is frightening. The 1986 trade deficit is expected to be even larger. Cutting out funding for Eximbank direct lending authority as proposed in the President's fiscal year 1987 budget is not advisable. Our exports will suffer and jobs may be placed at risk. ECAT urges the Congress to continue to support the direct credit program at its currently authorized level of $1.1 billion.

The need for the direct credit program will be stronger in the years immediately ahead, especially in debt-laden developing countries which are major markets for U.S. industry. Many of these countries will find it more difficult to secure financing for their imports from U.S. banks that may be financially overextended in the Third World. In the absence of help from the Eximbank, many Third World countries will lack the hard currency to "buy American." They will likely switch from U.S. technology and goods to those of foreign countries which are ready and able to make available the necessary direct credits.

American business both at home and abroad is under siege from very effective foreign competitors. The U.S. share of the world market is barely holding its own. We in business are doing what we can to increase our productive efficiencies in order to survive and prosper in the world marketplace.

We need and appreciate any help we can get from our government to meet the many foreign competitive challenges facing the American business community.

We have concerns about current proposals to diminish the Eximbank's authorities to facilitate U.S. exports. These proposals appear to be revenue-driven, written in the shadows of the federal budget deficit. Mr. Chairman, try to imagine the government of Japan handicapping its exporters in the manner of the Administration's Eximbank proposals!

THE INTEREST-MATCHING PROGRAM

ECAT has some additional concerns about the Administration's proposal to rely on an interest-matching program in place of a direct Eximbank lending program, particularly since the necessary funds to match the difference between the commercially available domestic interest rates and the foreign interest rates will come from the reserves of the Eximbank. Our concern is heightened by the Comptroller General's May 29, 1985, report to the Congress in which it is concluded that:

> "The Bank's financial statements do not include an allowance for estimated losses that are likely to be sustained due to the uncollectibility of a portion of the loans it has made. If such an allowance had been deducted, GAO estimates that the Bank's equity would have been decreased by $1.0 to $1.5 billion, eliminating substantially all of the $1.4 billion in equity accumulated from the Bank's results of operations."

Another question that we have about the proposed interest-equalization program is its cost. Some estimates place the cost considerably higher than that of the Bank's loan operations.

There is also the outside chance that the I-Match program will fail in a given instance to generate the necessary financing to meet an Eximbank commitment. Such a contingency, however remote, could be handled if back up authority and funds for direct loans remain intact.

For all these reasons, ECAT members question whether the I-Match program can ever be a substitute for the direct credit program -- leave alone whether I-Match is ready for full implementation. We believe that the Congress should consider giving I-Match a trial run as a supplement to the direct credit program. A trial run would provide an opportunity to compare the outcomes under I-Match and a continuing Eximbank direct credit program in actual financing undertakings. It would postpone a final decision on I-Match as a direct credit substitute until after I-Match is provided a real test.

When we testified on the Eximbank before the Senate Banking Committee on February 7, we strongly recommended -- as we also have today -- that the direct lending authorities of the Eximbank be retained and that an interest-matching program be experimented with but not as a substitute for direct loans. The recent indication of the Congressional Budget Office that the proposed interest-subsidization program would have to show as a budget expenditure just as would direct loans strengthens our belief that a direct lending authority of at least $1.1 billion is essential to assisting vitally needed U.S. exports.

MIXED CREDITS

From the perspective of Johnson & Johnson and other members of ECAT, it is essential that the Eximbank have the resources to combat the mixed credit practices of foreign governments.

This will require a strengthening of the bank's mandate to aggressively combat foreign predatory mixed credits. The enactment into law of the war chest proposal -- an issue on which your committee has been in the lead -- will play a vital role in this task.

A recent Brazilian experience of Johnson & Johnson illustrates the need for a strong mixed credit program.

In 1985 Johnson & Johnson was successful in securing a $44 million order for hospital equipment destined for a number of hospital systems in the State of Sao Paulo, Brazil. Johnson & Johnson coordinated this project and obtained participation from approximately 40 different U.S. equipment manufacturers in putting together the final order.

This project, however, could not have gone forward without support from the Eximbank. Through mixed credits, the French have taken over leadership in the hospital equipment market in Brazil. The Brazilian customers informed us that a French manufacturer was bidding for the hospital equipment contract, offering extremely concessionary terms, including two percent interest on a part of the costs as well as extended payment terms. The only chance was to persuade Eximbank to match the French financing package as closely as possible. The Bank did so and the U.S. consortium has now entered into final contract negotiations.

The result is critically important to Johnson & Johnson and the other suppliers because of the nature of the equipment involved. The vast majority of items destined for Brazil in this package consists of state-of-the-art diagnostic equipment, including magnetic resonance imagery. These items represent millions of dollars in research and development costs that can not be recovered in U.S. sales alone.

We realize that U.S. efforts to counteract foreign mixed credit competition have only been partly successful. France, Japan, and West Germany continue to siphon off attractive American export opportunities around the world through providing financial concessions.

Resources to combat foreign interest subsidies are scarce. Nonetheless, we are gratified that Eximbank saw the Brazilian market situation as one that required aggressive action. We hope that the Bank will continue to show a willingness to battle mixed credits around the world -- assuming it is given the necessary resources.

Without an institution like Eximbank that has U.S. exports as its primary mission and that continues to adhere to the "competitiveness" mandate of its Charter, we will lose substantial foreign sales and markets. We understand the hard choices Congress must make in the present budget situation, but we also see a tremendous potential for exporting the products of our medical technology if we can discourage foreign competitors from tipping the scales with government subsidies.

Medical technology offers unique opportunity for export growth because it is among the last areas in which the U.S. enjoys world leadership. Our competitors realize this because otherwise they would not perceive a need to offer major financing concessions. They do so because on even terms they know we would beat them every time.

CONCLUSION

Mr. Chairman, we urge the Congress to renew the authorities of the Eximbank for a period of six years, maintain Eximbank's mandate for direct credits at the currently authorized level of $1.1 billion, direct a trial run for the interest-matching program, and, within the

limits prescribed by the deficit situation, continue to encourage its active participation in fighting off foreign mixed credits. Only if the playing field on financing is even can Johnson & Johnson and other ECAT companies maintain the strong presence in world markets of which they are truly capable.

Thank you for your courtesy in having me here.

Chairman NEAL. Thank you, sir.

Mr. Warner, we would like to hear from you at this time.

STATEMENT OF MINER H. WARNER, VICE PRESIDENT, SALOMON BROS., INC.

Mr. WARNER. Thank you very much, Mr. Chairman.

My name is Miner Warner of Salomon Bros.

We favor the I-MATCH II Program. I make reference only to the long-term maturity. We favor the proposed I-MATCH II Program for three reasons: because it works, and with some slight modifications it would work very well. It also indicates very clearly the rate subsidy element in Eximbank's direct lending program, and it represents desirable diversification of funding of Federal credit programs and funding resources.

The I-MATCH II Program, as proposed, would work well. In Eximbank fiscal year 1983, $685 million was directly lent in 21 loans and in 1984, $1.1 billion in 29 loans. That is down from levels of approximately $4 billion to $5 billion in amounts of 130 to 140 loans in the early 1980's.

I do not have available 1985 statistics, but I believe it may be down somewhat from 1984. We would not imagine that there would be a resurgence of the loan volumes of the earlier 1980's, because the differential between direct lending rates offered by Eximbank and commercial rates were so substantially great then that that represented really terribly attractive money, and nobody who had access to direct lending would not take that.

Of course, some of the direct loans made are small.

On the other hand, Eximbank officials have indicated in conversations that not less than $10 million would be offered on an auction basis. On that basis, we can certainly say that $10 million and above is an eminently workable size for at least an auction. We estimate, based on the last 2 years, 1984 and 1983, that there would be approximately 20 to 25 direct loans auctioned by I-MATCH as loan substitutes during the year.

However, we recommend very strongly that the transferability provisions be modified to insure broad transferability, not only for the participation certificates, which has already been proposed, but above all, for the Eximbank guarantee itself.

If there is broad transferability of the guarantees, we would anticipate that given the following possible change, the cost to Eximbank would be no greater than its current cost.

At present, the source for Eximbank's direct funding is through the Federal Financing Bank with the funds made available at one-eighth over the yield on Treasurys of comparable maturity. OMB has proposed that, effective at the end of this fiscal year, that spread charged by FFB be increased from one-eighth to one-half. Incidentally, I should add that FFB, in the late 1970's, charged three-eighths over, and they decided to reduce that to one-eighth over, unilaterally.

According to the provisions of the FFB Act, no legislation is required. No actions are required, other than an administrative decision to increase or decrease the spread charged on FFB lending. If, in fact, the FFB were to charge Eximbank one-half over, it is our view that with broad transferability for a guarantee, the cost to Eximbank of the auction rate versus the cost of FFB funding would be a wash.

Let me just go on in terms of this request for a technical modification in terms of transferability of the guarantee. As a general proposition, all Federal guarantees which are financed in the private sector are freely transferable. Eximbank is, I believe, the only exception. To restrict transferability adversely impacts on pricing. In other words, the rate on the Eximbank guarantee is higher with restricted transferability and lower with less restrictions. The lower the rate on the guarantee, the less subsidy which Eximbank is required to make up in this direct loan subsidy program.

Transferability restrictions on the guarantee mean clearly defined and quantifiable red ink for Eximbank, and there is no reason for such restrictions.

There is a persistent myth: Guaranteed debt and Treasury debt are sold to one and the same investors. That categorically is not the case. It should be obvious, given the fact that guaranteed debt is always priced higher than direct debt.

Treasury markets are enormous, liquid and risk free. Excepting the GNMA markets, the guaranteed debt markets, on balance, are fragmented into many different programs, each with specific policy directives and different provisions and conditions, exactly like that contemplated under I-MATCH II.

There are, therefore, no practical reasons why, in fact, unrestricted transferability for the guarantee should not, in fact, be made available.

I think also, referring to the Budget Special Analysis—Part F, OMB is in agreement with those views. An associated myth has also been the crowding-out theory; namely, that there is a limited and finite pool of investable funds that Treasurys are competing for.

I have indicated already that, in our judgment, investors in guaranteed debt are different from investors in Treasury debt. They have different objectives. They are seeking a different quality instrument. Taken to its logical absurdity, junk bonds would be crowding out Treasurys in the market or vice versa, and that just is not the case.

In addition to the fact that the I-MATCH II Program is eminently workable, we also believe that it is desirable because the element of export subsidy is indicated quite clearly—not the entire subsidy, of course, because the guarantee makes available funds at

terms and conditions which would otherwise be unavailable from commercial sources, particularly for Third World countries, but it does give clearly the rate subsidy which is involved here.

There is precedent for such direct credit subsidies, not only in officially supported export credits, but actually right here at home in the United States with very major subsidy programs—the Government-guaranteed student loan program with large subsidies paid from the special account by the Department of Education to the domestic banks.

The beneficiary here in I-MATCH II would not, of course, be the domestic bank, but it would rather be the foreign exporter.

Finally, we favor the I-MATCH II Program, as it represents an important step in the diversification of funding sources for Federal credit programs. As noted, investors in Treasury bills are different from investors in guaranteed debt, different from investors in GNMA, different from investors in junk bonds. It makes good financial sense, given the aggregate credit demands on the capital market by the Treasury and various Federal credit programs, to diversify sources of funding.

It is interesting to note that, as of November 30, 1985, the Federal Financing Bank, which, as mentioned earlier, is the prime banker to Eximbank, was financing a loan portfolio of $154 billion in loan assets, virtually all of which could have been effectively financed in the private sector.

Of that $154 billion of loan assets, approximately 85 percent were lent to third-party nongovernmental agency borrowers.

So what is this? Why this subsidy, 85 percent at least, to nongovernmental borrowers, not a subsidy to Government agency borrowers.

The 85 percent, which also excludes Eximbank direct loans, again, there is no reason for a $154 million loan portfolio to be financed on a subsidized basis. This puts tremendous additional demands on Treasury issues and capital markets, and we all know that based on the last 4 years, total Treasury debt outstanding has just about doubled from $998 billion to $1.8 trillion.

Without doubt, a part of this buildup must be attributed to the significant growth in the Federal Financing Bank loan portfolio and the need to fund that portfolio.

Therefore, and in conclusion, we say that our third reason for support of the I-MATCH II Program is that by funding this through the private sector, this not only is a workable solution, not only does it indicate the degree of rate subsidy actually offered by Eximbank, but finally, this achieves a diversification of funding through the private sector and diversification is sound financial management.

Thank you.

[The prepared statement of Mr. Warner on behalf of Salmon Bros., Inc. follows:]

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TESTIMONY OF

MINER H. WARNER

GOVERNMENT FINANCE GROUP

SALOMON BROTHERS INC.

My name is Miner H. Warner, and I am Vice President and Manager of the Government Finance Group at the investment bank of Salomon Brothers Inc. I am familiar with the direct loan, insurance, and guarantee programs of the Export-Import Bank of the United States (Eximbank) and with the Federal Credit programs which finance both through the Federal Financing Bank (FFB) and the private sector. My familiarity with Federal credit programs dates from 1971, when I worked with William E. Simon who was then in charge of the Government Department at Salomon Brothers prior to his appointment as Secretary of the Treasury.

We favor the proposed I - MATCH II program with respect to longer maturity direct loan substitution for three reasons: (1) as proposed and currently drafted it works, and, subject to some modest technical modification, it could work very well; (2) it clearly indicates the rate subsidy element in Eximbank's direct lending program; (3) it represents a crucial and highly desirable diversification of Federal credit program funding sources.

(1) As currently proposed the I - MATCH program is eminently workable. I note that all my references to I-MATCH refer solely to longer maturity direct loan substitutes. In Exim FY' 83 $685 million was directly lent in 21 loans, and in Exim FY' 84 $1.122 billion was directly lent in 29 loans. This is

down from levels of approximately $4-5 billion and 130-140 loans in the early 1980's. We do not have available yet 1985 direct lending statistics but believe the direct loan volume may be down from the preceding year. Some of the loans are small. Extrapolating from prior years, we expect that there may be on the order of approximately 20-25 loans sufficiently large for auction purposes. 20-25 auctions during a year are readily acceptable to the marketplace, and we are of the view there would be sufficient bidding interest among certain major commercial and investment banks to assure satisfactory pricing of the I - MATCH program. Small loans, for example, less than $5 million, individually cannot be effectively accommodated by the market, but it is my impression from meetings with Eximbank that minimum loan size is expected to be not less than $10 million.

We recommend that the transferability provisions of the I - MATCH program be modified to insure broad transferability, not only for the participation certificates which is already provided for, but also for the Eximbank guarantee. As a general proposition, all Federal guarantees which are financed in the private sector are freely transferable. To restrict transferability adversely impacts on pricing. In other words, the rate on the Eximbank guarantee is higher with restrictive transferability and lower with less restrictions. The lower the

rate on the guarantee, the less subsidy which Eximbank will be required to make up. Transferability restrictions on the guarantee mean clearly defined, and quantifiable, red ink for Eximbank.

And there is no reason for such restrictions. Once there was a persistent myth that guaranteed debt and Treasury debt were purchased by exactly the same investors and that consequently guaranteed debt was in direct competition with, say, Treasury bills. From a market viewpoint, nothing could be further from the truth. This should be obvious given the fact that guaranteed debt always bears a higher yield than Treasury debt of comparable maturity. The Treasury markets are enormous, liquid, and risk free. Excepting the Ginnie Mae markets, the guaranteed debt markets on balance are fragmented into many different programs, each with specific policy objectives and with different provisions and conditions, like that contemplated under I - MATCH.

Guaranteed debt has limited liquidity, fungibility, and invariably investment risk, i.e., there is always a risk that the guaranteed borrower will default or prepay. Neither default nor prepayment enters into the thinking of investors in Treasuries.

By definition, investors in guaranteed debt have different criteria than investors in Treasury debt. The differences between Treasury debt and guaranteed debt, by the way, are amply recognized by OMB in the 1987 Budget. See Special Analysis F, p. F-18, Loan guarantees.

An associated myth has also been the "crowding out" theory, namely, that there is a finite pool of investible funds, and a dollar of guaranteed debt is competing against a dollar of Treasury debt for this same pool of investment dollars. As previously noted, investors in guaranteed debt are different from investors in Treasury debt because of the different characteristic of each. Taken to its logical and completely erroneous extreme, junk bonds, i.e., high yielding non-investment grade corporate bonds, would "crowd out" Treasuries or, conversely, be "crowded out" by them.

(2) We favor the I - MATCH program because it quantifies to a certain degree the element of export subsidy in substituted direct lending. Clearly identifying the element of subsidy permits a measure of Congressional oversight and review which would otherwise not be available. This is sound financial practice.

Of course, it should be noted that many if not most of the guaranteed borrowers are borrowing long term fixed rate funds

which, but for the Eximbank guarantee, would be unavailable from commercial sources. There is a credit subsidy, the cost of which is not being measured. However, what is being quantified (and subsidized) is the difference between the agreed officially supported export credit rates and the rate at which the Eximbank guarantee can be funded. And there is ample precedent for this procedure to be found not only in international officially supported export credit practice but also here at home in the Department of Education's guaranteed student loan program.

(3) Finally, we favor the I - MATCH program as it represents an important step in the diversification of funding sources for Federal credit programs. As already noted, investors in Treasury bills have different investment and yield objectives than investors in guaranteed debt. It makes eminent good financial sense, given the aggregate credit demands on the capital market by the Treasury and various Federal credit programs, to diversify sources of funding. In this connection, it is interesting to note that FFB as of November 30, 1985 was financing a $154 billion loan portfolio consisting of various insured and guaranteed financial assets, virtually all of which could have been effectively financed in the private sector. Some of these financial assets have maturities out to 40 years. In

brief, we note the anomalous result of multiple issuance by Treasury of short term Treasury bills to finance long term assets acquired by third party non-government agency borrowers. Why? With a loan portfolio of $154 billion, FFB funding requirements to finance this portfolio through Treasury in the capital markets are enormous. Total Treasury debt outstandings have gone from $998 billion in 1981 to $1,823 billion in 1985. A part of this build-up must be attributed to the significant growth in the FFB's loan portfolio and the need to fund that growing portfolio.

There are compelling reasons to reduce this heavy reliance on guaranteed financial assets funding through Treasury and to diversify sources of funding. Diversification in turn will necessarily reduce aggregate Treasury issuance which is a very positive development for the capital markets. And the proposed I - MATCH program is a small but important step in the direction of diversification. And diversification is sound financial management.

This ends the formal part of my testimony. I would be delighted to respond to the Committee's questions.

Chairman NEAL. Thank you, sir, very much. Mr. Williams.

STATEMENT OF LARRY WILLIAMS, VICE PRESIDENT OF MARKETING, CATERPILLAR TRACTOR CO.

Mr. WILLIAMS. Mr. Chairman, Congressman Leach. I am Larry Williams, vice president of marketing for the Caterpillar Tractor Co., and we are really on the firing line in respect to what is going on in the export finance world.

I appreciate the invitation to appear today before the subcommittee to present our views on the reauthorization of the Export-Import Bank.

My purpose today is not suggest whether Exim authorization should be off-budget or on-budget, or whether the subsidy element in export financing should alone be scored in the Federal budget, but I do propose covering in the next few minutes to why export financing is important to Caterpillar, what improvements are necessary to Eximbank programs and how these improvements would increase my company's export performance.

Caterpillar, as you well know, has long recognized the importance of international markets. Over the last 5 years, U.S. exports have accounted for an average of 34 percent of our annual business, and we have been a leading contributor to the balance of payments for years. In 1985, export sales provided jobs for some 16,000 U.S. Caterpillar employees and more than 30,000 employees of our U.S. suppliers.

Some 42 percent of the jobs of the 1,500 Caterpillar suppliers in districts represented on this subcommittee are dependent on our export sales.

Members of the subcommittee may also be interested to know that in 1984 Caterpillar purchased $141 million worth of goods and services from firms in their districts; $60 million of those purchasers went into export products.

In retrospect, there is an uncanny parallel between Caterpillar's fortunes and those of Eximbank. Like Caterpillar, the Bank suffered a loss in 1982, the first such loss in its 48 years of existence. Also like Eximbank, Eximbank during the last several years has developed new products and redirected its approach to existing ones. One example of this work is the current examination of the foreign content rules. We believe it is important that the Eximbank adjust its policy regarding foreign content to be consistent with overseas lending institutions. Particularly, the adjustment is needed for the direct credit and financial guarantee programs.

The importance of official export financing can only be understood in terms of the structure of U.S. trade. Record trade deficits over the past 4 years have centered primarily in the manufacturing sector. The prospects for reducing that deficit have improved with the fall of the dollar, but we at Caterpillar don't believe for a moment that our Nation's international competitiveness problems will be solved by the dollar decline alone. There is a wide range of other factors that are essential to improving U.S. trade performance and Eximbank can help address one of them.

Foreign firms that we compete against, are not going to give up markets they have gained over the past 4 years without a fight. In

fact, as exchange rate realignment helps to close the competitive pricing gap between our competitors and us, we expect to see greater, not less, foreign reliance on export financing to maintain market positions.

For example, through export insurance, guarantees and loans, Japan, the home of our major competitor, Komatsu, has typically provided official financing equal to 35 to 40 percent of its manufactured exports. France is at 20 to 25 percent and the United Kingdom between 35 and 40. The corresponding figure for the United States has averaged between 5 and 10. While other nations have established aggressive official export financing programs, Eximbank has reduced its support for American exports in recent years.

As Eximbank's charter comes up for renewal, we look for significant changes that can be made to increase the competitiveness of U.S. exports and halt the trend toward overseas production.

First and foremost is the issue of the length of authorization. We, like others, suggest a 6-year reauthorization, a period sufficient to establish a sense of continuity and certainty for the exporting community.

Perhaps the most controversial issue that will be taken up by this subcommittee is the proposal by the administration to replace Eximbank's direct lending programs with an interest rate buydown plan known as I-MATCH.

Now before I touch on the I-MATCH Program. I want to point out that Caterpillar believes that the Eximbank's present direct lending programs remain the simplest and most cost-effective method for providing official financing support to American exporters. The existing program is not without problems, but it nevertheless is workable and a proven approach to meeting foreign export financing.

But Mr. Chairman, over the last several months, we have come to recognize that as long as the current budget treatment of Eximbank continues, the direct lending program is in danger of further decline, if not elimination. Under these circumstances, we were willing to consider a second-best solution, and I underscore "second-best," an interest buy-down scheme, such as I-MATCH.

But in light of the recently announced intent of the Congressional Budget Office to score the entire value of Eximbank-supported exports under I-MATCH as opposed to the subsidy element only, we have to question the merit of moving toward the I-MATCH Program. In fact, if the CBO scoring approach is followed, then we can see no reason to advocate I-MATCH.

We differed with the administration on their proposal to immediately discontinue funding authorization for the Eximbank direct lending program in favor of their I-MATCH alternative. A more prudent policy would be to maintain funding for the direct lending program until the alternative program, if one is adopted, is up and working.

Mr. Chairman, regardless of whether I-MATCH or some other alternative is ultimately adopted by this Congress, we believe the debate that I-MATCH has fostered and the internal analysis it prompted within Eximbank are valuable.

We strongly suggest that the improvements proposed within I-MATCH II be included in the resulting lending program, whatever its form may be.

While I-MATCH or an alternative will likely be the most controversial issue during the Eximbank reauthorization, there are other issues which deserve attention, and briefly, mixed credits.

The Eximbank has recently offered a number of mixed credit packages aimed at countering the use of this financing practice by other nations.

This new aggressiveness on the part of the Bank is a welcome development. However, one of the problems which persists is that current law limits the Agency for International Development to using only the funds available in its commodity import programs.

We favor the elimination of this restriction so that money in the AID economic support fund could also be used for mixed credits.

THE COMPETITIVENESS MANDATE

We realize that no matter how the competitive mandate is drafted, its impact on Eximbank operations will be more hortatory than real.

Nevertheless, we support a refinement of the mandate to emphasize that as a matter of standard practice the Bank's program should be available on the best terms available under the OECD guidelines governing official financing practices.

As an example of the present situation, the OECD guidelines define medium term insurance as 2 to 5 years in length and short term as less than 2 years. In practice, however, the United States and most OECD countries have normally considered short-term insurance to be 360 days or less, rather than the full 2 years. Eximbank has made this latter unofficial practice a hard and fast policy.

Japan, on the other hand, has within the legal boundaries of OECD selectively stretched the definition for short-term insurance to as much as 720 days, just under 2 years. Given this flexibility, they are able to offer our potential customers a more competitive financing package.

As a result, in 1985 Caterpillar lost $31 million in sales into one market alone, and in 1986 we will likely lose $8.5 million in sales plus other additional business because of this internal policy.

In adhering to this self-dictating policy, Eximbank has refused to match this competitive Japanese practice.

RISK ASSUMPTION

In many countries throughout the world, Eximbank will not engage in new loan commitments even though other overseas governments will. In the case of many countries, the Bank's standard for reasonable assurance of repayment effectively closes the door for American companies trying to do business in these markets.

For example, Eximbank recently denied an application from a new private company in Chile. At stake was the sale of Caterpillar equipment for a mine project which would provide coal for Chilean consumption, replacing fuel oil imports.

Canadian and possibly German export financing facilities agreed to provide financing without a Chilean Government guarantee. The

International Finance Corporation, the World Bank's sister organization, also agreed. Our own Eximbank refused to provide the required financing.

In such cases we suggest it would be preferable for the Bank to examine loan applications from a standard such as reasonable expectation of repayment rather than reasonable assurance of repayment.

We would also suggest that Congress request the Bank—in its annual competitiveness report—to provide a list of countries where official financing was being offered by other nations but not by Eximbank. This report should also list any applications formally considered and denied by Eximbank for customers to whom assistance was ultimately offered by a foreign country.

Loan coverage, another issue which Eximbank could usefully address, includes financing for local costs on projects. Such financing could be restricted to local purchases of U.S. products; for example, replacement parts from an in-country Caterpillar dealer.

THE 2 PERCENT FEE

In 1981, the Eximbank announced a 2-percent application fee that was to be charged on all loans made by the Bank. The purpose of this fee, as outlined in an Eximbank press release, was to "improve the Bank's net income immediately."

Regardless of whether this 2-percent fee is considered an insurance premium or bank fee, U.S. companies are disadvantaged.

Other nations have the flexibility to drop insurance fees down to whatever level necessary to compete for business on key projects.

We favor the elimination of the 2-percent fee or, alternatively, that Eximbank allow the borrower to repay the fee over the entire term of the loan.

ADVISORY COMMITTEE

In 1983, Congress directed the Eximbank to establish a private sector advisory committee, which was to meet on a regular basis with Eximbank officials. This advisory committee has served a useful purpose in looking at very general issues involved in Eximbank policy and operations. And although Eximbank does work on an ad hoc basis with technically oriented private sector representatives, we believe that a permanent technical advisory committee required to meet on a regular basis would serve as a useful link between American exporters and the Eximbank.

In conclusion, I would like to thank the subcommittee for the opportunity to testify today. The reauthorization of the Eximbank is an important issue for the Caterpillar Tractor Co. and for American industry as a whole.

In many respects, the extent to which the United States is prepared to maintain a strong Eximbank has become a barometer for our Government's interest in trade competitiveness.

Eximbank must be an essential element in any creditable plan aimed to restore our competitiveness in world export markets.

Thank you.

[The prepared statement of Mr. Williams on behalf of the Caterpillar Tractor Co., follows:]

STATEMENT OF
LARRY WILLIAMS
VICE PRESIDENT, CATERPILLAR TRACTOR CO.

REGARDING
1986 REAUTHORIZATION OF THE EXPORT-IMPORT BANK
BEFORE THE
SUBCOMMITTEE ON INTERNATIONAL FINANCE, TRADE &
MONETARY POLICY
OF THE
COMMITTEE ON BANKING, FINANCE & URBAN AFFAIRS

Mr. Chairman, members of the Subcommittee, I am Larry Williams, Vice President, Caterpillar Tractor Co. I appreciate the invitation to appear today before the Subcommittee to present our views on the issue of reauthorization of the Export-Import Bank. My purpose today is not to suggest whether Eximbank authorizations should be "off budget" or "on budget" or whether the subsidy element in export financing should alone be scored in the federal budget. What I do propose covering in the next few minutes is why export financing is important to Caterpillar; what improvements are necessary to Eximbank programs and how these improvements would increase my company's export performance.

Caterpillar, has long recognized the importance of international markets. Over the last five years U.S. exports have accounted for an average of 34 percent of our annual sales.

In 1985 export sales provided jobs for some 16,000 U.S. Caterpillar employees and more than 30,000 employees of our U.S. suppliers. In fact Mr. Chairman, some 42% of the jobs at the 1500 Caterpillar suppliers in districts represented on this Subcommittee are dependent on our export sales. Members of the Subcommittee may also be interested to know that in 1984 we purchased $141 million of goods and services from firms in their districts. About $60 million of those purchases went into exported products.

In retrospect there is an uncanny parallel between Caterpillar's fortunes and those of the Eximbank. Like Caterpillar, the Bank suffered a loss in 1982 -- the first such loss in its 48 years of existence. Also, like Caterpillar, the Eximbank during the last several years has developed new products and redirected its approach to existing ones. Examples are: new leasing programs; the small business credit programs, the medium term credit program; and establishment of a separate marketing division within Eximbank. Eximbank has improved old programs, as evidenced by the recent decision to increase direct loan cover from 65 to 85 percent. And it is working on correcting weaknesses in various existing programs. One example of this work is the current examination of foreign content rules. We believe it's important that Eximbank adjust its policies regarding foreign content to be consistent with overseas lending institutions. In particular an adjustment is needed for the direct credit and financial guarantees guarantee programs.

The Bank has also been able to reduce costs by successfully negotiating an international agreement to automatically adjust OECD interest rates to more closely parallel market rates.

We believe that as Eximbank's older, higher cost loans are retired and replaced by narrower-interest-spread loans the Eximbank balance sheet will improve.

But more needs to be done to improve official financing support for U.S. exporters.

Case for Eximbank

The importance of official export financing can only be understood in terms of the structure of U.S. trade. Record trade deficits over the past four years have centered primarily in the manufacturing sector.

The prospects for reducing that deficit have improved with the fall of the dollar. But we at Caterpillar don't believe for a moment that our nation's international competitiveness problems will be solved by dollar decline alone. There is a wide range of other factors that are essential to improving U.S. trade performance. Eximbank can help address one of them.

The foreign firms that we compete against are not going to give up markets they have gained over the past four years without a fight. In fact, as exchange rate realignment helps to close the competitive pricing gap between our competitors and us, we expect to see greater, not less, foreign reliance upon export financing to maintain market positions.

For example, through export insurance, guarantees, and loans, Japan - the home of our major competitor, Komatsu - has typically provided official financing equal to 35-40 percent of its manufactured exports. France is at 20-25 percent, and the United Kingdom between 35-40 percent. The corresponding figure for the U.S. has averaged between 5-10 percent.

While other nations have established aggressive official export financing programs, Eximbank, has reduced its support for American exports in recent years.

Nothing illustrates this point better than the data contained in Chart 1 attached to my testimony. It shows the value of U.S. exports supported by Eximbank programs as a percentage of U.S. manufactured exports for 1972 through 1985. The Chart shows a dramatic fall in the level of support available to U.S. exporters. The percentage of U.S. manufactured exports supported by Eximbank declined from 28 percent in 1972 to 13 percent in 1980 to 7 percent in 1984.

A recent Commerce Department study on structural change in the U.S. economy contains data which demonstrates the enormous erosion in U.S. competitiveness. Chart #2 shows what happened to U.S. exports -- U.S. market share as a percent of the world market dropped from 18 percent in 1960 to around 15 percent in 1970 to 11 percent in 1984.

Again, it would be wrong to attribute all of this to the reduction in Eximbank support. A good portion of our country's competitiveness problem stemmed from the overvalued U.S. dollar. But there's no doubt that on occasion non-competitive official financing support has hurt Caterpillar sales efforts.

Eximbank Reauthorization

As Eximbank's charter comes up for renewal, we believe there are significant changes which can be made to increase the competitiveness of U.S. exports and halt the trend toward overseas production.

First and foremost is the issue of the length of the authorization. We suggest a six year reauthorization...a period sufficient to establish a sense of continuity and certainty for the exporting community.

Perhaps the most controversial issue that will be taken up by this Subcommittee is the proposal by the Administration to replace Eximbank's direct lending programs with an interest rate buydown plan, known as I-Match.

Before touching on the I-Match program I want to point out that Caterpillar believes the Eximbank's present direct lending programs remain the simplest and most cost effective method for providing official financing support to American exporters. The existing program is not without problems, but it nevertheless is a workable and proven approach to meeting foreign export financing.

But, Mr. Chairman over the last several months we came to recognize that as long as the current budget treatment of Eximbank continued, the direct lending program was in danger of further decline, if not elimination. Under these circumstances, we were willing to consider a second best solution -- an interest buydown scheme -- such as I-Match.

Today, in light of the recently announced intent of the Congressional Budget Office to score the entire value of Eximbank supported exports under I-Match - as opposed to the subsidy element only - we have to question the merit of moving toward the I-Match program. In fact, if the CBO scoring approach is followed, then we can see no reason to advocate I-Match.

We differed with the Administration on their proposal to immediately discontinue funding authorization for the Eximbank direct lending program in favor of their I-Match alternative. A more prudent policy would be to maintain funding for the direct lending program until the alternative program - if one is adopted - is up and working.

Mr. Chairman, regardless of whether I-Match or some other alternative is ultimately adopted by this Congress, we believe the debate that I-Match has fostered and the internal analysis it prompted within the Eximbank are valuable. We strongly suggest that the improvements proposed within I-Match II be included in the resulting lending program...whatever its form may be.

While I-Match or an alternative will likely be the most controversial issue during Eximbank reauthorization, there are other issues which deserve attention:

Mixed credits -- The Eximbank has recently offered a number of mixed credit packages aimed at countering the use of this financing practice by other nations. This new aggressiveness on the part of the Bank is a welcome development.

However, one of the problems which persists is that current law limits the Agency for International Development (AID) to using only the funds available in its Commodity Import Programs. We favor the elimination of this restriction so that money in AID's Economic Support Fund (ESF) could also be used for mixed credits.

Competitiveness mandate -- We realize that no matter how the competitiveness mandate is drafted its impact on Eximbank operations will be more hortatory than real. Nevertheless, we support a refinement in the mandate to emphasize that as a matter of standard practice the Bank's programs should be available on the best terms allowable under the OECD guidelines governing official financing practices.

As an example of the present situation, the OECD guidelines define medium term insurance as two to five years in length and short term at less than two years. In practice, however, the U.S. and most OECD countries have normally considered short term insurance to be 360 days or less (rather than a full two years). Eximbank has made this latter, unofficial practice a hard, fast policy. Japan on the other hand has - within the legal boundaries of the OECD - selectively stretched the definition for short term insurance to as much as 720 days...just under two years. Given this flexibility they are able to offer our potential customers a more competitive financing package.

As a result, Caterpillar lost $31 million in sales into this market, and in 1986 will likely lose an $8.5 million sale plus other additional business because of this internal policy. In adhering to this self-dictated policy Eximbank has refused to match this competitive Japanese practice.

Risk assumption -- In many countries throughout the world, Eximbank will not engage in new loan commitments, even though other overseas governments will. In the case of many countries, the Bank's standards for "reasonable assurance of re-payment" effectively closes the door to American companies trying to do business in these markets. For example, Eximbank recently denied an application from a new private company in Chile. At stake was the sale of Caterpillar equipment for a mine project which would provide coal for Chilean consumption, replacing fuel oil imports. Canadian and possibly German export financing facilities agreed to provide financing without a Chilean government guarantee. International Finance Corporation (IFC), the World Bank's sister organization, also agreed. Our own Eximbank refused to provide the required financing.

In such cases we suggest it would be preferable for the Bank to examine loan applications from a standard such as "reasonable expectation of repayment", rather than "reasonable assurance of repayment".

We would also suggest that the Congress request that the Bank, in its annual competitiveness report, provide a list of countries where official financing was being offered by other nations, but not by Eximbank. This report should also list any applications formally considered and denied by Eximbank for customers to whom assistance was ultimately offered by a foreign country.

Loan coverage -- The Eximbank has recently increased from 65 percent to 85 percent the amount of an export transaction that will be covered under its direct credit program. Caterpillar supports this effort by the Bank to improve the competitiveness of its programs. Another issue which Eximbank could usefully address includes financing for local costs on projects. Such financing could be restricted to local purchases of U.S. products, for example, replacement parts from an in-country Caterpillar dealer.

2 Percent Fee -- In 1981, the Eximbank announced a 2 percent application fee that was to be charged on all loans made by the Bank. The purpose of this fee, as outlined in an Eximbank press release, was "to improve the Bank's net income immediately".

Regardless of whether this 2 percent fee is considered an insurance premium or bank fee, U.S. companies are disadvantaged.

Other nations, have the flexibility to drop insurance fees down to whatever level necessary to compete for business on key projects.

We favor the elimination of the 2 percent fee or alternatively that Eximbank allow the borrower to repay the fee over the entire term of the loan.

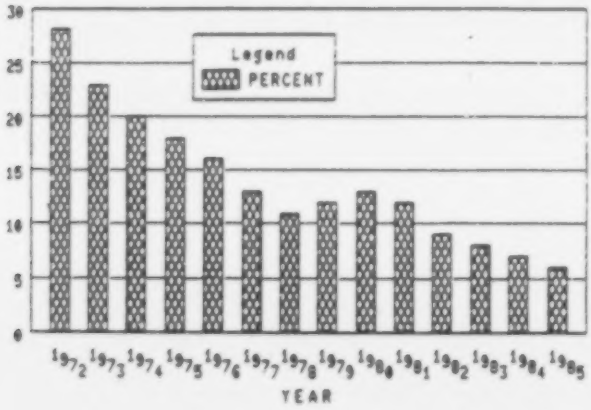
Leasing program -- The Eximbank recently announced guidelines for a new program to support the leasing of American products by foreign customers. This is an important step toward bringing Eximbank services into line with international commercial realities. Leasing is an increasingly popular approach to "selling" Caterpillar-type products into international markets. We appreciate Eximbank's initiative in developing this new program.

Advisory committee -- In 1983, Congress directed the Eximbank to establish a private sector advisory committee which was to meet on a regular basis with Eximbank officials. This Advisory Committee has served a useful purpose in looking at very general issues involved in Eximbank policy and operations. And, although Eximbank does work on an ad-hoc basis with technically-oriented private sector representatives, we believe that a permanent technical advisory committee, required to meet on a regular basis, would serve as a useful link between American exporters and the Eximbank.

Conclusion

I would like to thank the Committee for the opportunity to testify today. The reauthorization of the Eximbank is an important issue for Caterpillar Tractor Co. In many respects the extent to which the U.S. is prepared to maintain a strong Eximbank has become a barometer for our government's interest in trade competitiveness. Eximbank must be an essential element in any credible plan aimed to restore our competitiveness in world export markets.

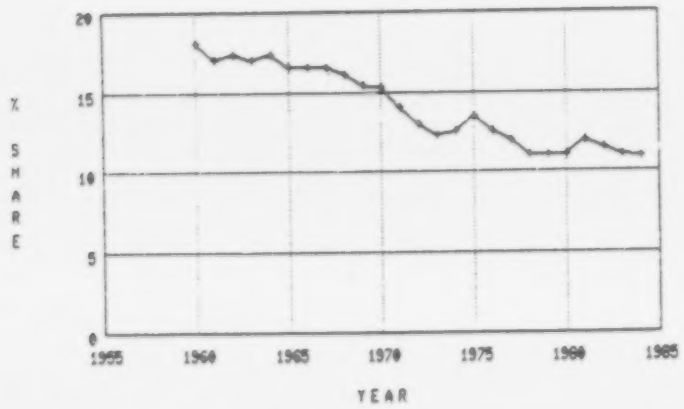
CHART 1: The Value of U.S. Exports Supported by Exim Programs as a Percentage of U.S. Manufactured Exports



By NAM from Eximbank Annual Reports

Data for 1977 includes Exim Programs during the transition quarter between FY 1976 and FY 1977

CHART 2: U.S. Share of World Exports



By NAM from Commerce Department data

Chairman NEAL. At this time I would like to ask unanimous consent to put in the record a statement submitted by the Fertilizer Institute and also a letter from Eximbank concerning some revisions they are suggesting in the proposed I-MATCH Program.

Without objection, so ordered.

[The statement and letter submitted for the record by Chairman Neal follow:]

Statement of

THE FERTILIZER INSTITUTE

on

EXPORT-IMPORT BANK REAUTHORIZATION

before the

House Banking Committee
Subcommittee on International Finance, Trade
and Monetary Policy

February 25, 1986

The Fertilizer Institute
1015 18th Street, N.W., Washington, D.C. 20036
202-861-4900 Telex 89-2699

58-662 O - 86 - 7

Since created in 1934, and established as an independent government agency in 1945, The Export-Import Bank (Eximbank) has had the basic purpose "... to aid in financing and to facilitate exports ..." Among its statutory obligations is the responsibility to take into account the effect of its activities on small businesses, the domestic economy, and U.S. employment.

The Fertilizer Institute* supports these premises for the programs of Eximbank. In a number of instances, members of the fertilizer industry have participated in and have been beneficiaries of programs of the Eximbank. Thus, at the outset we want to applaud efforts of the Eximbank where it has adhered to its statutory obligations and where its programs have had net benefits to U.S. domestic industries.

However, for several years The Fertilizer Institute has been opposing financial assistance from the Eximbank to expand phosphate production in North Africa. This assistance, exceeding $200 million during 1979-85 to Morocco and Tunisia, has been extended by Eximbank despite the fact that the world phosphate industry in this period was, and still is, in a structurally overbuild position.

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*The Fertilizer Institute is the national association for the U.S. fertilizer industry. Its members (including producers, retailers, equipment suppliers and trading firms) account for 95 percent of the fertilizer produced domestically, and essentially all fertilizer exported.

This assistance also has been extended despite facts showing that in this period U.S. phosphate capacities and production were losing much of their share of the world market to North African production.

Using data for 1984, loss of U.S. share in the world phosphate market represented a loss exceeding $200 million in foreign exchange. Also, with phosphate production cut back, there was an additional loss of domestic employment income in 1984 of $450 million. Thus, there was a total loss of approximately $650 million in the single year of 1984 to the U.S. resulting from the depressed world phosphate market, and loss of U.S. share in this market.

Obviously, not all of this loss can be attributed to the $200-million assistance from the Eximbank to Morocco and Tunisia. However, a significant part of this loss can be directly attributed to this Eximbank assistance to two of the largest competitors with the U.S. industry in the world phosphate market.

BACKGROUND

The primary purpose, therefore, of the fertilizer industry's participation in this investigation is to identify programs and policies of the Eximbank that have resulted in this detrimental net

effect to the U.S. economy. The Eximbank's performance, as with any organization, must be based on a comparison of its record with the prescribed objectives. As a government agency, Eximbank should strictly adhere to the statutory requirements set forth by Congress.

Clearly, the objective of the Eximbank is to enhance U.S. exports by facilitating the financing of these exports. However, Congress has realized that such export enhancement programs can have both positive and negative effects on the U.S. economy. To ensure that the Eximbank's loan practices do not adversely affect U.S. industries, the bank's statutory authority states two conditions it will avoid:

- Serious adverse effects of loans or guarantees on the competitive position of the U.S. industry, including an evaluation of effects on employment and the competitive position of U.S. exporters. (12 U.S.C. 635(b)(i)(B))
- Funds for the Eximbank will not be used for loans for establishing or expanding production of any commodity for export by any country other than the U.S. if the commodity is likely to be in surplus on world markets, and if the assistance will cause substantial injury to U.S. producers of the same, similar, or competing commodity. (FY 1986 continuing resolution by the U.S. Congress)

Additionally, in 1978, Congress amended the Bank's charter so as to provide the following:

> The Bank shall implement such regulations and procedures as may be appropriate to ensure that full consideration is given to the extent to which any loan or financial guarantee is likely to have an adverse effect on industries, including agriculture, and employment in the United States either by reducing demand for goods produced in the United States or by increasing imports to the United States. To carry out the purpose of this subsection, the Bank shall request, and the U.S. International Trade Commission shall furnish, a report stressing the impact of the Bank's activities on industries and employments in the United States. Such reports shall include an assessment of previous loans or financial guarantees and shall provide recommendations concerning general areas which may adversely affect domestic industries, including agriculture, and employment.

In 1983, this provision was amended to authorize appropriations of funds to finance this study. To date, however, the Bank has not adopted any such regulations, explaining that it has not done so because funds have not been appropriate.

Evidence submitted in this statement will show that the Eximbank, by providing financial assistance to phosphate producers in North Africa, has deviated from two of its statutory guidelines:

- It has provided assistance to foreign producers of phosphates which in turn have increased production and exports resulting in economic injury to U.S. producers, and
- This assistance has been granted in the face of evidence that phosphates are in surplus on world markets.

Tables 1 and 2 summarize projects of the Eximbank since 1979 assisting Moroccan and Tunisian phosphate operations. All of the projects have been approved by Eximbank to the detriment of the U.S. fertilizer industry.

Not shown in Table 1 is a $35-million operating facility for Morocco which the Bank did deny in 1984. The fertilizer industry objected strongly to this project in 1984, providing extensive evidence of the structurally over-built position of the world phosphate industry. Since about 1980, the U.S. phosphate industry has been in a structurally over-built position and no Eximbank assistance should have been provided to foreign producers of phosphates. This assistance has penalized the U.S. phosphate producers because North African phosphate producers have steadily increased their share of the world phosphate market.

Table 3 shows phosphate rock production capacities during the past several decades. By 1986, U.S. production capacity increased 42 percent over 1970. However, compared with African capacities and African/Near East capacities, U.S. expansions have lagged far behind the large expansions in other regions. North African phosphate capacities in 1986 were several times greater than in 1970. Even with the international recognition of an over-build phosphate industry, expansions in Africa and the Near East are continuing unabated.

TABLE 1

MOROCCO

Eximbank Assistance,
Fertilizer Industry,1980-1985

Date	CRNO Eximbank	Project	Type	Board Authorization ($ millions) Capital	Non-Capital	Total
Jan 80	06780	OCP - Mining Equip.	Direct Loan	$10.5		
Nov 80	06952	OCP - Construction Equip.	Direct Loan	17.5		
Mar 81	07048	OCP - Multi-project	Credit Loan		35.0	
Oct 81	07048	OCP - Mining Equip.	Sub-loan	3.6		
Mar 82	07177	Locomotives & Spare Parts	Direct Loan	13.0		
Jan 84	07328	Locomotives & Spare Parts	Loan Guarantee		0.7	
Jan 84	07327	Locomotives & Spare Parts	Direct Loan	5.4		
June 84	00020	OCP - Superphosphoric Acid Plant	Loan Guarantee		2.1	
Oct 84	00029	OCP - Blast Hole Drills	Loan Guarantee		4.8	
Nov 84	00042	OCP - Dragline	Loan Guarantee		2.1	
Dec 85	07431	OCP - Mining Equip.	Direct Loan	1.2		
TOTAL 1980-1985				$51.2	$44.7	$95.9

SOURCE: Eximbank Printouts, January 1986

TABLE 2

TUNISIA

Eximbank Assistance,
Fertilizer Industry, 1980-1985

Date	CRNO Eximbank	Project	Type	Board Authorization ($ millions) Capital	Non-Capital	Total
Sept 79	06673	Gov't. of Tunisia - Multi-Projects	Line of Cretit		$100.0*	
Jan 81	06673	Phosphate Mining Equipment	Sub-loan	$ 3.2		
Sept 81	06673	Diesel Electric Locomotives	Sub-loan	20.0		
	TOTAL			$23.2	$100.0	$123.2

*general purpose

SOURCE: Eximbank Printouts, January 1986

TABLE 3. Phosphate Rock Production Capacities

	U.S.	Morocco/ Tunisia) (Million Metric Tons)	African/ Near East
1970	40	16	27
1980	60	28	48
1986	57	42	72
Early 1990's	-	59	106
Percent increase, 1986 over 1970	42	162	166

SOURCE: National Fertilizer Development Center, TVA, January 1986.

In Table 4, phosphate rock capacities of various regions are expressed as percent of world market share. The table shows that the percentage for the U.S. has been declining significantly since 1970 while increasing sharply for capacities in Africa/Near East. Further plans of Africa and the Near East will lead to a market share exceeding 42 percent. Data in Table 3 and Table 4 vividly show the declining position of U.S. phosphate producers in the world market while, conversely, showing the ascending position of phosphate producers in North Africa and the Near East. The important points these tables make are that foreign phosphate producers are expanding capacities despite a structural over-supply in the world market, and that U.S. producers are being injured as a result of foreign expansions.

TABLE 4. Percent of World's Market Share of Various Regions' Phosphate Rock Capacities

	U.S.	Africa/Near East
	(% of World Market Share)	
1970	43	30-
1980	38	30+
1986	30	38

SOURCE: National Fertilizer Development Center, TVA, January 1986.

Processed products of phosphate rock also are important when evaluating the international phosphate picture. Increasingly, finished phosphates such as phosphoric acid and ammonium phosphates are becoming more important in international trade than phosphate rock. In this connection, it is notable that, while the U.S. phosphate industry continues to operate at abnormally low operating rates for these finished phosphate products, and while many of its finished phosphate plants are closed, plants for these same products in North Africa are expanding at an unabated pace.

In Africa and the Near East, wet processed phosphoric acid capacities increased from 1 million tons of P_2O_5 in 1970 to 3 million in 1980. By 1986, capacity for this product in this region doubled over 6 million tons of P_2O_5 per year, and plans have been announced for expanding this product capacity to over 9 million tons by the early 1990s. Again, as in the case of phosphate rock, the U.S. share for wet process phosphoric acid has dropped sharply in recent years ... from 45 percent in 1970 to 32

percent in 1986, with a further indicated drop to 27 percent in theearly 1990s. In contrast, capacities for this product in North Africa and the Near East will increase their share of international capacities from 7 percent in 1970 to 12 percent in 1980, and to 19 percent in 1986. Indicated increases by the early 1990s will give this region 22.5 percent of the world's capacity.

Penalties to the U.S. Industry

A significant point in comparing the U.S. phosphate industry with the African and Near East phosphate industries is that much of the U.S. phosphate production is for domestic consumption. Thus, domestic supplies of phosphates for agriculture depend greatly on the well-being of the domestic U.S. phosphate industry. Other major phosphate producers place very little of their production in their respective domestic markets. Instead, they look at the international market, and their increased exports in this commodity market directly displace tonnage from U.S. producers.

It is noteworthy that among its procedures identified in a memorandum of the Eximbank, January 5, 1979, regarding adverse domestic impact of Eximbank financing, there is the identification of transactions involving displacement in third market countries. For example, a plant built in North Africa for phosphates could

sell its production in the European Community and compete with exports coming directly from the United States. This is precisely what has occurred as North Africa has expanded its phosphate production.

With the world phosphate industry in a structurally over-built position, U.S. capacities and production are losing much of their world market share. Much of this loss appears to be a direct result of increased production in North Africa, part of which has been built with the assistance of Eximbank financing. The U.S. fertilizer industry recognizes the sovereign right of North African countries, operating through governmentally owned and controlled production facilities, to expand their production of phosphates. However, the U.S. fertilizer industry does not think this expansion should be assisted with U.S. funds such as those provided by Eximbank.

In a world market for a commodity item, such as phosphate rock or finished phosphates, one producer's advantage is another producer's disadvantage. To compound these problems, the U.S. phosphate industry is one of the very few remaining private sector industries in the world with this commodity, and it competes with facilities wholly-owned by governments or as parts of centrally controlled economies, which are rapidly increasing their share of the world market. With such a commodity situation, what one producer increases, in effect, is largely a loss for another.

In a recent study conducted for The Fertilizer Institute on the world phosphate situation and effects of Eximbank programs, it has been estimated that between 1980-1984 the U.S. lost 3.2 percent of the total world market share of phosphate rock. Total market for this product in 1984 was 48.1 million metric tons, thus the loss of 3.2 percent represented 1.5 million tons of phosphate rock exports. At a value of $28 per ton, this loss represented $43 million in foreign exchange earnings in 1984.

With similar comparisons for finished phosphate products, estimates are that the U.S. lost 4 percent of its share of the international market. In 1984, with total exports of 10.9 million tons of finished phosphates expressed as P_2O_5, the U.S. lost exports of over 0.4 million tons of P_2O_5. At an estimated value of $370 per ton P_2O_5, this loss in foreign exchange in 1984 was equivalent to $160 million. Thus, for the two products, the total loss in exports in 1984 alone was more than $200 million in foreign exchange earnings.

In terms of number of employees, the Institute study shows that in 1980 the phosphate rock mining industry had 14,620 employees. By 1984, this had decreased to 12,500, a loss of 2,120. In the industry for processing finished phosphates from this raw material, employment in 1980 was 15,600, but decreased in 1984 to 13,200, with a loss of 2,400 employees. Thus, the U.S. phosphate industry

lost 4,520 employees in the four-year period while the Eximbank was assisting North African industries to expand their phosphate capabilities. Economists typically use the figure that, for each person directly employed in mining and manufacturing, there are three indirect support type employees. Thus, one can calculate a total employment loss of over 18,000 between 1980 and 1984 at a time when world total phosphate markets were growing, and with increasing shares being taken by competitors in North Africa and the Near East.

At an estimated annual salary of $25,000 per employee, one can calculate an employment income loss of $450 million in 1984 alone.

Thus, with this figure of $450 million in employment income lost in 1984, and with $200 million lost in foreign exchange earnings from lost exports, one arrives at a total figure of $650 million lost in 1984 by the U.S. as a result of declining market shares for U.S. phosphate producers and the resultant drop in employment.

All this loss cannot be attributed to expansions in North Africa as a result of Eximbank support. However, a significant part of this loss can be directly attributed to Eximbank assistance in expanding phosphate production in North Africa. We think Eximbank would not have spent more than $200 million in the last

several years in that region had it followed the congressional guidelines for its operations, namely that it will not provide assistance to an industry that is structurally over-built, and that it will not provide assistance to a foreign industry whose subsequent increased exports will result in economic injury to the U.S. economy.

SUMMARY

Clearly, the $200 million assistance from the U.S. Eximbank to North African phosphate producers in recent years has resulted in increased world capacity and increased exports of phosphates from those producers in direct competition with U.S. producers. With this record, the Eximbank should immediately cease all assistance to foreign state-owned or state-controlled phosphate operations, and should strictly follow the statutory guidelines which Congress has set for similar industries.

BANK

EXPORT-IMPORT BANK OF THE U.S.
811 VERMONT AVE. N.W.
WASHINGTON, D.C. 20571

FIRST VICE PRESIDENT AND VICE CHAIRMAN

February 24, 1986

The Honorable
Stephen L. Neal
Chairman, Subcommittee on
International Finance, Trade
and Monetary Policy
Committee on Banking, Finance
and Urban Affairs
U.S. House of Representatives
Washington, D.C. 20515

Dear Mr. Chairman:

In Chairman Draper's testimony before your Committee, he indicated that the Bank would continue to discuss the I-MATCH II program with exporters, bankers, and others with the objective of further refining and improving it. As a result of these conversations, we have identified several technical changes to the I-MATCH II program.

The principal changes build directly upon the Bank's existing financial guarantee program. Specifically, the I-MATCH II program now will provide for the servicing of the private loan to be performed by the originating lending bank and will permit floating rates to the funder throughout the disbursement period in the long-term program. The foreign purchaser will continue, of course, to receive the fixed Arrangement rate and Exim will make up the difference, if any, between the Arrangement rate and the floating rate.

All loan servicing for both the long-term and medium-term programs will be performed by the originating lending bank. The commercial bank will be the lender to the foreign borrower, and all promissory notes will be issued to the commercial bank. Disbursements will be made by the commerical bank and all repayments will be made to it, thus the commercial bank will service the loan. Exim will serve as a guaranteeing institution.

The definition of "budget authority" continued in Section 3 (a)(2) of PL. 93-344 (The Congressional Budget and Impoundment Control Act of 1974) specifically excludes authority to guarantee or insure the repayment of indebtedness incurred by another person or government from the definition and calculation of budget authority, as does the definition of "spending authority" in Section 401 (c)(2).

Under I-MATCH II, Eximbank is exercising its authority to guarantee, therefore I-MATCH II guarantees are specifically excluded from the calculation of budget authority by the provisions of the Congressional Budget and Impoundment Control Act. Consequently, we believe that this program, as structured, should have the same budgetary treatment as all other government guarantee programs.

Indeed, financial accounting standards do not require that a liability be recorded for a contingency unless there is a reasonable probability that a loss has occurred. Budget authority figures for I-MATCH II will reflect the losses associated with I-MATCH II as they occur.

We believe that these changes will make the program more flexible and useful to U.S. exporters. I would be pleased to discuss these changes with you at any time.

Sincerely,

John K. Bohn, Jr.

Chairman NEAL. Mr. Warner, several times during your testimony you said that the I-MATCH Program is workable.

How do we know?

Mr. WARNER. Well, we have a reasonable feel for the capital markets, and looking at and extrapolating from the past, the number of transactions one could expect during the year and conditions of those transactions, such as maturity, such as the fact that there would be a single disbursement in a timely fashion, it is our judgment that commercial banks and investment banks and possibly other eligible financial institutions would certainly make a satisfactory market for those obligations on a continuing basis.

Now, if in point of fact the guarantee were to be modified so that it is freely transferable and made a true auction kind of guarantee as opposed to a private placement kind of guarantee, not only could we say that the funds would be readily available for this rather limited type of transaction—maybe it would be a billion dollars a year—but that the rates would be extremely competitive. Moreover, those rates would be quite competitive with funds offered by the Federal Financing Bank, if in fact the OMB policy change to increase the FFB's spread is in fact administratively enacted by Treasury.

Chairman NEAL. On that point, why should the Federal Financing Bank charge more?

I mean, your point, as I understand it, was that if they charge more—you said it went out to one-half of 1 percent, I believe—then the cost of the direct loan in the I-MATCH Program would be comparable. If they went up to 5 percent or 10 percent or 20 percent, obviously, it would be even more favorable to the I-MATCH.

But why should they? Isn't the Federal Financing Bank essentially just a mechanism for raising and redistributing capital?

Mr. WARNER. Well, I would say, first of all, Mr. Chairman, as I mentioned, the margin charged by FFB has in the recent past been three-eighths of 1 percent. What the policy objective is in charging this spread is to charge some reasonable market differential between what it costs the Treasury to borrow directly and what third-party nongovernment agency borrowers should be paying in the market.

Now, in point of fact, Eximbank guarantees if freely transferable could be marketed in this kind of maturity at 50 basis points over, the differential then would be three-eighths, and that differential would be neatly captured, if you will, if in fact that margin went from one-eighth up to one-half, FFB's margin is quite discretionary there, although again from policy readings over the years, the stated policy has been that the difference between the Treasury rate and the guaranteed rate should be reflected in that spread.

So, what is the reason now to impose a spread of 5 percent, for example, 500 basis points—would be totally unreasonable if any realistic effort was being made to measure that spread.

Chairman NEAL. Is it not also just to recover its own costs? Is not the spread a reflection of the need to recover the cost of operating the Federal Financing Bank?

Mr. WARNER. There are two costs in operating the Federal Financing Bank. One cost is, if you will, kind of the official cost. The other cost, which is much larger but is the real cost, that is, the

spread arguably between the FFB's loan portfolio, which goes out to assets of 40 years, and the cost of Treasury's financing of those assets.

Despite the fact that FFB supposedly has a matched book with Treasury, that of course is impossible because Treasury doesn't offer 40-year bonds.

What we have seen over the years, particularly in the very high rate environment, has been an FFB which has been immensely costly because, like the savings and loan institutions, the yield on its underlying loan portfolio assets was much lower than its cost of financing short.

So there are two costs here, one of which is officially recognized and the other of which is much more important, which is not.

Chairman NEAL. As I understood it, the idea was just to raise the capital to fulfill what administrations and Congresses over the years have decided was in the public interest.

Mr. WARNER. Well, if I may just add a point there, the FFB Act of 1974 contemplated that the Federal Financing Bank would be a self-financing agency. If it had been a self-financing agency, it would be quite clear to see whether the portfolio was costing the agency money or not.

In point of fact, after one issuance of short-term bills, the FFB, contrary to the contemplation of its creators, was just folded into the Treasury. The FFB, therefore, has not, in that regard certainly, acted in a way consistent with the original concept of the FFB.

Some Federal assets are financed in the bank, some are not. Some guarantee programs are financed in the bank, some are not. Far and away the largest guarantee program is not financed in the bank, and that is the Ginnie Mae Program.

Chairman NEAL. Thank you, sir, very much.

Mr. Leach.

Mr. LEACH. I have only one question.

The other day, the representative from General Electric testified that he expected his company to be in a far greater competitive position in the coming year. Therefore, he believed the resources of Exim might be tapped to a greater extent.

Do you feel that is likely to happen from the industries that you represent?

Let me particularly ask Mr. Williams, who represents one of the great manufacturing companies in the world that has great importance in my region. [Laughter.]

Mr. WILLIAMS. We think that the currency shifts have put us into a better position to work in the world's marketplaces. But our competitors from around the world and their governments are not going to let the current flow of goods shift without a battle. On that basis, we believe we would be in greater need for support from Eximbank under the projected economic circumstances of 1986 than in the recent past.

Mr. LEACH. Are you saying that the GE representative was overstating the case for improved trade?

Mr. WILLIAMS. Well, I can't speak for GE. I am involved in world business on a daily basis, and can report that there is a lot of business out there. But I can tell you it is still very difficult, and we don't see our competitors rolling over playing dead.

Mr. LEACH. Is there enough business out there to stave the lines at the Davenport Caterpillar Works?

Mr. WILLIAMS. We are getting into a private discussion here, sir. [Laughter.]

Mr. LEACH. It is a private discussion of some significance.

Mr. KLECZKA. You want to talk, Mr. Chairman, about the Caterpillar operation in Milwaukee.

Mr. LEACH. But in any regard, things are upbeat compared to what they were 6 months ago?

Mr. WILLIAMS. We are somewhat more positive in our outlook for our sales opportunities, and this outlook underlies the need for a competitive export financing program.

Mr. LEACH. And you feel that it could be solved through the I-MATCH approach or the direct lending approach?

Mr. WILLIAMS. We are a bit apprehensive about I-MATCH inasmuch as it is still an unproven. As the chairman has suggested, we think some of the things that have been suggested in I-MATCH II are excellent thoughts. But we believe that commercial banks, notwithstanding what we just heard, have not confirmed their interest in the rate guarantee approach in I-MATCH.

One of the things that I am particularly concerned about is that the business we regularly engage in—in parts of the world which are not attractive to the banks—might be allowed to slip through the crack in an I-MATCH approach. Without a test program, it's impossible to tell if these types of markets would be covered within I-MATCH.

For example, take Mexico or Peru, or any of the oil-producing nations of the world, where the banks are already overextended.

Mr. LEACH. Thank you very much.

Chairman NEAL. Mr. Kleczka.

Mr. KLECZKA. Thank you, Mr. Chairman. I have a question for Mr. Williams.

Mr. Williams, in your testimony, you indicate there is a wide range of other factors that are essential to improving U.S. trade performance. Do you want to take a couple of those off? Repetition is the mother of learning.

Mr. WILLIAMS. That is true.

Mr. KLECZKA. One, I am sure, is the budget deficit of which, as you know, the cuts in funding for Exim is part of that whole program.

Mr. WILLIAMS. We might start with the total attitude. We, as a nation, in respect to the importance, have not considered exports essential to our economic strength.

With due respect to Exim and the other agency funds that are available to further exports, we just don't stand up to the rest of the world.

So I would start by saying, wouldn't it be better if we could begin thinking in terms of exports as being an important part of our way of life.

Export controls have been a major problem for Caterpillar. We have lost considerable business in recent years through foreign policy controls, where we were in the midst of transactions with a number of countries which we were ultimately forced to walk away from. We ended up shooting ourselves in the foot, losing hundreds

of millions of dollars in sales to other countries, Japan being one in particular.

Mr. KLECZKA. But the major things Congress can do to improve that climate. Admittedly, for 5 years, we have just let the problem slip away from us and somebody woke up, including Members of Congress in 1985 and 1986, faced with a $150 to $160 billion trade deficit, but nevertheless, that being said and the deficit being here, what do you recommend Congress do about it?

Mr. WILLIAMS. You would start with a position on the part of Government to further export as a way of life. Many times around the world, I have taken U.S. commercial attachés and introduced them to the business that was going on in their part of the world. We just don't get the degree of ongoing support—for example, in the form of marketing intelligence—from our foreign service missions that our competitors receive from their people.

Mr. KLECZKA. I am still not clear as to what you want us to do.

Mr. WILLIAMS. All right.

Mr. KLECZKA. You are reluctant to mention the budget deficit.

Mr. WILLIAMS. The budget deficit is a factor.

Mr. KLECZKA. But you have to admit that is part of the problem.

Mr. WILLIAMS. That is true. Obviously, in large part the budget deficit has affected the value of the dollar versus other nations' currencies.

Mr. KLECZKA. Also the interest rate problem.

Mr. WILLIAMS. Absolutely. Aggressive export financing.

Mr. KLECZKA. Gosh, that's a good one. Let's mark that one down, Mr. Chairman.

Mr. WILLIAMS. Realistic export controls, which we just talked about, inadequate export promotion, and, of course, the strong dollar, interest rates and the budget, the deficit, have all come together to cause us to go through quite a reduction in our ability to effectively compete in world markets.

Mr. KLECZKA. Are you aware of anything in the legislation pending before Congress dealing with the trade deficit, the Rostenkowski bill, which provided a 25-percent surcharge or the other bill?

Mr. WILLIAMS. I am not totally aware of that.

Mr. KLECZKA. The other bill would change radically the GATT agreements to ensure a level playing field.

Mr. WILLIAMS. A level playing field would be beneficial so long as achieving it doesn't cause more harm than good around the world in the process.

Mr. KLECZKA. Thank you, Mr. Williams.

Mr. Chairman, I think the debate about funding for Exim will go on as long as this President is in power. His proposals will always include a deletion of the program and a substitution with an I-MATCH.

I still would like to pursue my thoughts, which we shared to the committee last year on providing for a pilot program. Salomon says it is going to work. Caterpillar says maybe we will try it. Others will say it is going to fall on its face. And the debate goes on as the funding for Exim dwindles. I think one of these days together, we should introduce legislation which would start with a pilot I-MATCH Program. Let's see if there is going to be participation. Let's see if the banks are going to be cooperative. Let's see if it is

going to work, but to sit here and hear from both sides indicating yes, it will, no it won't. I guess the proof of the pudding is in the eating.

So I would hope that this year maybe we could move ahead with a proposal which starts off with a small pilot program well-defined by Congress, maybe to the tune of $250 million or so, and let's see what actually happens out there.

If you gentlemen or the lady would like to comment on that, I would sure appreciate it.

Mr. VELDEN. That is basically the position we support. We don't feel that the Direct Credit Program should be dropped totally until we see how the I-MATCH Program works. If it works, great. We shouldn't drop the Direct Program immediately.

Mr. KLECZKA. That I fully agree with.

Laura, do you want to respond?

Ms. GOLDHAR. Yes. I would suggest that the program may be workable, and I would suggest if the pilot program is concerned, that there would be a backup of the existing Direct Credit Program. There are many things that the Direct Credit Program is needed for for certain types of transactions that would be affected, not by the I-MATCH Program. The question is, it is a question of size and time, in terms of determining whether or not it is workable. That has to be one of the considerations in trying to structure a pilot program.

Mr. KLECZKA. Mr. Warner, would you like to respond?

Mr. WARNER. Mr. Congressman, I have addressed myself only to the long term as opposed to medium-term program, because the long-term program, in my conversations with Eximbank would be the program in which investment banks and other eligible financial institutions could participate. So I pass no judgment on medium programs. In terms of the long-term program, it would be our view that in the event it is structured properly and, hopefully, with completely transferrable guarantee, that it would work pretty well.

Mr. KLECZKA. Thank you. Thank you, Mr. Chairman.

Chairman NEAL. Thank you.

I think that we have distributed to each of you a letter from Eximbank, and I direct your attention especially to paragraphs 2 and 3, in which the Eximbank is suggesting some further changes in the proposed I-MATCH II Program.

I would welcome especially the bankers' comments and those of all of you, but especially the bankers.

You might want to read those paragraphs, and if you would like to submit some thoughts for the record, that would certainly be fine. If you have some thoughts you would like to share with us now, that would be fine also.

Yes, sir, Mr. Warner.

Mr. WARNER. Mr. Chairman, if I may, I just saw this coming in here today. I have had an informal conversation with our friend from Eximbank here, but I don't fully perhaps appreciate all the nuances. What I would prefer to do is reserve judgment and give comments.

Chairman NEAL. Ms. Goldhar.

Ms. GOLDHAR. I would agree with that.

Chairman NEAL. Please do that. Why don't you all think about it and all of you, please, we would certainly welcome all of your thoughts on this.

Let me thank our distinguished panel. Your testimony was very useful to us. We will certainly pay attention to it, as we proceed with our deliberations.

We meet again Thursday at 10 to hear from the Congressional Budget Office on how they are going to be scoring the proposed alignment.

Thank you all.

The committee will stand adjourned until Thursday morning.

[Whereupon, at 11:10 a.m., the hearing was adjourned, subject to he call of the Chair.]

THE CHARTER RENEWAL OF THE EXPORT-IMPORT BANK

THURSDAY, FEBRUARY 27, 1986

HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON INTERNATIONAL FINANCE,
TRADE AND MONETARY POLICY,
COMMITTEE ON BANKING, FINANCE AND URBAN AFFAIRS,
Washington, DC.

The subcommittee met at 10:07 a.m. in room 2222 of the Rayburn House Office Building, Hon. Stephen L. Neal (chairman of the subcommittee) presiding.

Present: Chairman Neal; Representatives Levin, Leach, and Chandler.

Chairman NEAL. I call the subcommittee to order at this time.

Today we conclude the last of our planned series of hearings on the reauthorization of the Export-Import Bank. Our witness this morning is James L. Blum, Assistant Director for Budget Analysis of the Congressional Budget Office. He has been invited to explain why CBO differs so sharply from the Office of Management and Budget in its scoring of the Eximbank's I-MATCH proposal.

As I understand the CBO decision, I-MATCH would be scored as though it were a direct loan program, even though it purports to replace direct loans with a combination of guarantees and interest subsidy payments.

I have always argued that I-MATCH is, in essence, nothing but a direct loan program by another name and that we should adopt it only if it offered some real improvements over the existing direct loan program. Since it seems to offer no real advantage over direct loans, and since it would probably be more costly than direct loans, I have not been an enthusiastic champion, to say the least, of the I-MATCH proposal. I have always regarded the budgetary savings the administration claims would flow from I-MATCH to be totally phony.

Nonetheless, I never doubted that, however phony, they would appear as a bookkeeping reduction in the Federal deficit. Now the CBO has ruled that, at least in its scoring, there would not even be a bookkeeping reduction.

I would like to stress one fundamental point about the CBO interpretation. It treats certain guarantees—those associated with I-MATCH—as though they were direct loans. Direct loans generate outlays, so these guarantees are regarded as generating outlays.

However, other Eximbank guarantees—those not associated with I-MATCH—are not regarded as generating outlays. This appears

to be inconsistent. Nonetheless, I can see good sense in this interpretation. Please let me explain.

The real inconsistency, which is long standing, is the differing budgetary treatment given to guarantees and to direct loans. Both serve to allocate credit to purposes the Government wants to promote. From that point of view, they should be treated the same—either on budget, off budget, or in a separate credit budget of their own.

If we were completely redefining budget concepts and the budget process, I would urge a drastic rethinking of loans and guarantees, with a view to putting them on the same budgetary footing.

But we are not, and CBO is not, redefining the whole budget. Until we do, we are stuck with the budget concepts we have in place, including the unfortunate distinction between loans and guarantees.

As long as this distinction persists, there is a great temptation to exploit it to achieve entirely phony budgetary reductions by switching from loans to guarantees, with no real changes in the substance of the program, and no real change in its impact on the economy.

The I-MATCH proposal is a blatant example—and not, I fear, the only one—of the administration succumbing to that temptation.

CBO was faced with a difficult choice: it could, by adhering to narrow interpretations of loans and guarantees, acquiese in I-MATCH's phony budget reduction, or it could decide that, since I-MATCH would change nothing of substance, it should not be scored as budgetary savings. It could not suddenly redefine the whole budget to eliminate entirely the inconsistent treatment of all loans and guarantees. At most, it could avoid displaying I-MATCH as something it is not, namely, meaningful deficit reduction.

Are there any other opening comments? Mr. Leach.

Mr. LEACH. I share the chairman's concern that this is not a meaningful budget reduction. On the other hand, never have we had the definitional issue of more consequence to the American export community.

The fact of the matter is there is a great case to be made that a direct loan shouldn't have to be an on-budget item. But I think that the case that I-MATCH is making and the administration is making is very powerful, that is the I-MATCH proposal should be off budget.

There are elements of this that are clearly off budget; yet, there is certainly an aspect that isn't totally different from the current program.

But I would personally suggest very strongly that the administration's position be backed. It's a very thoughtful position.

I have the sense that what we are having here is a battle of people in kind of an economic "Webster's war." I just hope that a little flexibility and a little sensibility can prevail in this whole argument.

Thank you, Mr. Chairman.

Chairman NEAL. Thank you. Mr. Chandler.

Mr. CHANDLER. No statement, Mr. Chairman.

Chairman NEAL. Well, I would just make one more comment.

We are facing an enormous budget deficit. The real question is whether we are going to try to deal with that deficit in real terms or whether we are going to try to phony it up by some paperwork.

It seems to me that we could set a good example here and I would hope that the example would be used throughout government, and let's focus on the real need, which is reducing the budget deficit, not budget gimmicks. That is my concern.

Anyway, at this time, we would like to hear from Mr. James L. Blum, Assistant Director, Budget Analysis, the Congressional Budget Office.

Mr. Blum.

STATEMENT OF JAMES L. BLUM, ASSISTANT DIRECTOR, BUDGET ANALYSIS, THE CONGRESSIONAL BUDGET OFFICE, ACCOMPANIED BY MARVIN PHAUP AND JOSEPH WHITEHILL

Mr. BLUM. Thank you. Mr. Chairman. I would like to introduce two colleagues who are accompanying me this morning. On my left is Marvin Phaup, who is a senior analyst in our budget concepts and process area, who has done a lot of work with credit programs. And on my right is Joe Whitehill, who is our budget analyst for programs in the international affairs function, which includes the Export-Import Bank.

Chairman NEAL. Thank you. We would like to welcome both of your colleagues.

Mr. BLUM. Mr. Chairman, I am pleased to have an opportunity to appear before this subcommittee. My statement this morning will explain the Congressional Budget Office's budgetary treatment of the administration's proposal to convert the Direct Loan Program of the Export-Import Bank into a 100 percent loan guarantee with an interest buy down.

The Office of Management and Budget credits this proposal with a reduction in 1987 outlays and the deficit of approximately $0.2 billion. In our analysis of the President's budget, which was released yesterday, with copies given to the subcommittee, we estimated that the proposal would increase outlays and the deficit by $0.1 billion. This is in relation to our baseline budget projections that were submitted to the Budget Committees a week ago.

Underlying these different budget treatments is a difference in interpretation of the nature of the proposal. CBO believes that the administration's proposal entails no substantive programmatic changes from the existing Direct Loan Program.

Accordingly, we believe there is no basis for a change in budgetary scoring. The increase in outlays shown in our analysis of the President's budget reflects the increase in requested activity from the level authorized for direct loans in fiscal year 1986.

OMB, in contrast with CBO, and contrary to its own previously expressed credit program policies, has treated the nominal change from direct loans to 100 percent guaranteed loans, combined with an interest subsidy, as a decisive programmatic restructuring.

Under current policy, Eximbank originates loans to selected foreign buyers of U.S. goods at subsidized, OECD-agreed interest rates and finances these loans by borrowing from the Federal Financing Bank. The subsidy conveyed includes the difference in interest

rates between the loan rate and the FFB rate, plus the risk of default.

Under the proposed policy, the FFB would be bypassed as a source of financing. Funding would be obtained directly from commercial lenders who would assume no more credit risk than they do on U.S. Treasury securities, but who would require additional compensation for the lower liquidity of Eximbank-guaranteed notes.

Eximbank would continue to provide an interest-rate subsidy, but would do so under this proposal through interest makeup payments to commercial lenders. Eximbank would continue to bear full liability for all default risk.

The proposal would not affect amounts loaned, borrowers served, the subsidy conveyed, or the Government's liability. The intent, in fact, is to leave borrowers unaffected by the change. The only substantive effect, in our view, would be to increase the cost of financing to Eximbank and to the Government. This is because commercial lenders would not be able to provide funds to the program as cheaply as the FFB and the Treasury have been able to do.

The Eximbank proposal exposes a well-known deficiency in Federal budget accounting, which you alluded to, Mr. Chairman. Direct loan disbursements by Government during a fiscal year are treated as equivalent in budget cost to an equal dollar expenditure for grants or salaries and wages. This treatment is faulty because loan repayments are expected, and these repayments reduce the real cost of the loan outlay.

OMB estimates, for example, that the Eximbank Direct Loan Program conveys a subsidy with a present value of only 6.4 cents per dollar obligated instead of a full dollar. The budgetary practice of scoring the dollar volume of direct loan activity overstates the long-term savings obtained by reducing direct loan obligations in existing programs.

For example, if a $1 billion Direct Loan Program is terminated, this appears to save $1 billion, even though the subsidy saved is only a fraction of this, $64 million in the case of Eximbank loans.

Budgetary accounting for loan guarantees is also inadequate. Loan guarantee commitments are not recorded in the unified budget until a default occurs. Thus, loan guarantees appear to be "free" of budget cost until the Government has to honor its commitment to pay someone else's debt.

These deficiencies in the budgetary treatment of Federal credit assistance create incentives for program managers, seeking short-run budgetary savings, to convert Direct Loan Programs to guarantees. This incentive is especially strong when the conversion can be to 100 percent guarantees with an interest buy down, because this means that the substance of the program is unchanged, but that budget savings may be claimed.

No meaningful programmatic difference exists between a direct loan made by Government at a subsidized interest rate for which the Government is fully liable for default, and a loan originated by a private lender at the same rate for which the Government is liable for the interest subsidy and default.

OMB has previously recognized that a 100 percent guaranteed loan is essentially equivalent to a direct loan. In August 1984, OMB

issued its Circular A-70, "Policy and Guidelines for Federal Credit Programs." One goal of this circular was to prevent agencies from obtaining illusory budget savings by substituting 100 percent guarantees for equivalent direct loans.

Accordingly, Circular A-70 contained a general prohibition of new 100 percent loan guarantees and suggested that private lenders be required to assume at least 20 percent of the loss from default.

In those cases where 100 percent guarantees must be used, A-70 indicates that these instruments ordinarily should be financed through the FFB; that is, they should be converted explicitly into direct loans. The source of disagreement between CBO and OMB over the Eximbank proposal is the inconsistency of this plan with the principles embodied in the administration's credit policies.

Both CBO and OMB agree that the true cost to Government of Federal credit activity is its subsidy cost. Without great difficulty, the current proposal could be modified to permit the budget to reflect accurately its interest subsidy costs.

This could be achieved, for example, by having Eximbank pay the interest subsidy in one, up-front sum using appropriated funds. Further, the plan could be made fully compatible with the policies outlined in Circular A-70 by reducing the guarantee to 80 percent.

Mr. Chairman, that concludes my statement and I would be happy to take any questions.

[The prepared statement of Mr. Blum on behalf of the Congressional Budget Office follows:]

Statement of
James L. Blum
Assistant Director
Budget Analysis
Congressional Budget Office

Mr. Chairman, I am pleased to have the opportunity to appear before this Subcommittee. My statement this morning will explain the Congressional Budget Office's (CBO's) budgetary treatment of the Administration's proposal to convert the direct loan program of the Export-Import Bank of the United States into a 100 percent guarantee with an interest rate buydown. The gist of the matter is that whereas the Office of Management and Budget (OMB) credits this proposal with a reduction in 1987 outlays and the deficit of $0.2 billion, in our analysis of the President's budget, we estimated that the proposal would increase outlays $0.1 billion.

Underlying these numerical differences is a difference in interpretation of the proposal. CBO believes that the Administration's proposal entails no substantive programmatic changes. Accordingly, we have no basis for a change in budgetary scoring. The increase in outlays shown in our analysis reflects the increase in requested activity. OMB, in contrast with CBO and contrary to its previously expressed policies, has treated the nominal change from direct loans to 100 percent guaranteed loans combined with an interest subsidy as a decisive programmatic restructuring.

Under current policy, Eximbank originates loans to selected, foreign buyers of U.S. goods, at subsidized, OECD-agreed interest rates and finances those loans with borrowing from the Federal Financing Bank (FFB). The subsidy conveyed includes the difference in interest rates between the loan rate and the FFB rate plus the risk of default.

Under the proposed policy, the FFB would be bypassed as a source of financing. Funding would be obtained directly from commercial lenders who would assume no more risk than on U.S. Treasury securities but who would require additional compensation for the lower liquidity of Eximbank guaranteed notes. Eximbank would continue to provide an interest-rate subsidy, but would do so under this proposal through interest make-up payments to commercial lenders. Eximbank would continue to bear full liability for all default risk.

The proposal would not affect amounts loaned, borrowers served, the subsidy conveyed, or the government's liability. The intent, in fact, is to leave borrowers unaffected by the change. The only substantive effect, in our view, would be to increase the cost of financing to Eximbank and the government because commercial lenders would not be able to provide funds to the program as cheaply as the FFB and Treasury have been able to do.

The Eximbank proposal exposes a well-known deficiency in federal budget accounting. Direct loan disbursements by government during a fiscal year are treated as equivalent in budget cost to an equal dollar expenditure for grants or salaries and wages. This treatment is faulty because loan repayments are expected and these repayments reduce the real cost of the loan outlay. OMB estimates that the Eximbank direct loan program conveys a subsidy with a present value of only 6.4 cents per dollar obligated instead of a full dollar. The budgetary practice of scoring the dollar volume of

direct loan activity overstates the long-term savings obtained by reducing direct loan obligations in existing programs. For example, if a $1 billion direct loan program is terminated, this appears to save $1 billion even though the subsidy saved is only a fraction of this, $64 million in the case of Eximbank loans.

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These deficiencies in the budgetary treatment of federal credit assistance create incentives for program managers, seeking short-run budgetary savings, to convert direct loan programs to guarantees. This incentive is especially strong when the conversion can be to 100 percent guarantees with an interest buy-down, because this means the substance of the program is unchanged but that budget savings may be claimed. No meaningful programmatic difference exists between a direct loan made by government at a subsidized interest rate for which the government is fully liable for default and a loan originated by a private lender at the same rate for which government is liable for the interest subsidy and default.

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Both CBO and OMB agree that the true cost to government of federal credit activity is its subsidy cost. Without great difficulty, the current proposal could be modified to permit the budget to reflect accurately its interest subsidy costs. This could be achieved by having Eximbank pay the interest subsidy in one, up-front sum using appropriated funds. Further, the plan could be made fully compatible with the policies outlined in the A-70 by reducing the guarantee to 80 percent.

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Chairman NEAL. Thank you, Mr. Blum.

Mr. Leach.

Mr. LEACH. Mr. Blum, do you have a copy of the February 24 letter from John Bohn, the Chairman-designate of Exim?

Mr. BLUM. Yes, sir; I have seen that letter.

Mr. LEACH. The letter suggests that modifications could be encompassed in the program, modifications clearly in the direction of making it more of an approach that might be outside the framework of direct lending.

Does this approach reopen your thinking on the issue or are you going to stand in concrete?

Mr. BLUM. As I understand the nature of the suggestion in the letter, the only change being made in the proposal is with respect to the servicing of the loans, which would shift from Eximbank to the originating lending bank.

This change in administrative design is not, I think, a very significant change in the nature of the proposal. It's a detail, but I don't think it changes the——

Mr. LEACH. It may not be significant. But wouldn't you recognize that it's a close call? Or do you think that it's not a gray area at all, and when you have close calls, small changes can move it in a different direction?

It is like a football game. You can be almost offsides or you can be offsides. And you have to make a close distinction. It strikes me that in a close call, this shifts the burden of proof of that.

Do you think that's the case or not?

Mr. BLUM. Personally, I wouldn't think that that would be the case, Mr. Leach. I think it's only really a very minor detail. The substance of the nature of the program is essentially unchanged. It does not make this, I think, any more a loan guarantee under the guidelines as set forth in A–70 than the original one.

Mr. LEACH. Why does your testimony, if I may ask, focus primarily on the proposed 100-percent guarantee by I–MATCH loans while overlooking the warehousing and the servicing components of the program?

Is there not, in fact, more of a gray area in the distinction between the Direct Loan and the Guaranteed Program?

Mr. BLUM. I think, as my statement has indicated, the present budgetary treatment for credit programs leaves a lot to be desired. There is an element of arbitrariness I guess in making decisions with respect to budgetary scoring. But the guiding issue here, I think, whether there is something of a significant programmatic change in the proposal. Is it really different from a Direct Loan Program in substance?

I think the answer to that is no.

Mr. LEACH. In your report that you released yesterday of the President's budgetary proposals, CBO discussed the proposed nature and terms of the I–MATCH Program, including selection of borrowers and servicing of the loan. Yet, these issues aren't discussed in your testimony today.

Are these issues no longer significant in helping distinguish between a direct loan and guaranteed loan or does CBO have some differences of opinion?

For example, are your conclusions the unanimous view of the CBO? Are there people who have different perspectives?

Is there anyone in your institution that thinks that there might be gray areas of judgment?

Mr. BLUM. I frankly don't know, Mr. Leach, whether that's the case or not. But my statement this morning does represent the views of the Director of the Congressional Budget Office and my views, as well as those of my staff.

Mr. LEACH. In your conclusion, you suggest that the adoption of the risk-sharing formula, where the Government would reduce its risk guarantee to 80 percent to make the I-MATCH plan more compatible with the policies outlined in the policy and guidelines for Federal credit programs.

But isn't there another way of achieving the same objective, by modifying the terms of I-MATCH to include loan servicing and warehousing components, such as the revised I-MATCH, which is kind of a hybrid guarantee program?

Mr. BLUM. I would want to think about that before giving any specific reply. But I think the policy as set forth in A-70 is that proposed new credit programs that are to be loan guarantees should include significant risk taking by the private sector. That guideline I think is a very good one with which we would have no disagreement. But as to a warehousing risk or the equivalent, I couldn't say offhand.

Mr. LEACH. Let me just say, I personally appreciate very much the professionalism of CBO. I think it's an institution that has served this Congress well and it's an institution to which this Congress should give great deference. But there is an honest difference of opinion between the administration and CBO.

I just hope that you recognize that, when Congress makes this decision, that it will be a decision that will be a very important one and one that I think CBO's recommendation is going to have to be looked at very carefully. But it isn't the only advisory group that we are going to have to pay attention to.

I personally am very disappointed that there is this contrasting perspective because at stake could well be the future of substantial Federal involvement in the export community.

My own sense is that if the issue is as close as I think it is, we ought to give the benefit of the doubt to dealing with the problem rather than with the subtleties in definition making.

But I don't want to disregard the importance of that definition making. And given the closeness of the call, I hope we give the final measure of burden to what's important for the national interest, which I think at this time is assisting the export community. And I think this definition is far more than some sort of academic abstractions, given the tenor of the times and the choices Congress is making.

And I think when we really go back and think it through, that even though you are right, there are certain analogies to the present program, it's the fault of Congress that we never took the Direct Lending Program off budget in the first place. And to hang our hat on the aspect of this program being similar to direct lending I think is a mistaken notion.

So I'm hopeful that even though your testimony has been pretty tough, that Congress will look at all perspectives and particularly that of the administration at this time and that we give the benefit of the doubt, not so much to the administration vis-a-vis the CBO, but the export community vis-a-vis the abstract definition writers.

Thank you.

Chairman NEAL. Would the gentleman yield to me?

Mr. LEACH. Yes, of course.

Chairman NEAL. I have noted from the testimony of the exporting community that has appeared here over the last several days of our hearings that all of them seem to favor the Direct Lending Program because it's tried and true and we know it works and we know it's less expensive than this other approach, and so on.

I would ask my distinguished colleague to elaborate a little further on what he means by putting the Export Promotion Program in some jeopardy because we try to deal with it in a realistic accounting method. I am just not following that.

Mr. LEACH. Well, I would make two distinctions. One, everyone that I have heard has somewhat of a bias for keeping the Direct Lending Program as long as the resources are there. But everyone has also indicated that if it looked like those resources were in doubt, they would vastly prefer shifting to I-MATCH. Particularly in talking to witnesses after their formal testimony, I found virtual unanimity on that perspective.

Now in terms of the integrity of the accounting system, it's my view, and I think I have heard it from a number of Members on the majority side as well, that there is real doubt that this type of financing should ever have been on budget. It is a problem that the Congress has dealt with in the past and has always kept it on budget. I personally feel that a better accounting practice would have been to have it off budget to begin with, and there are a number of outside economists that share that perspective.

So I don't think the issue is one of integrity of accounting. I do think, though, that we all recognize that whether Gramm-Rudman is held constitutional or not, Congress can no longer continue to have guns and butter and bigger deficits. We are going to be choosing between guns and butter with a lower deficit.

And in that perspective, Exim is going to be a potential target. And I would stress here again that with the change in circumstances that's occurred outside of this whole concept of Federal budgeting—that is, the weaker dollar and the lower interest rates which are making American exports suddenly more competitive compared to the last few years—there is going to be a greater demand on Export-Import Bank resources. And with that greater demand, because of our greater competitive position that we hope is starting to evidence itself, we can't play games by putting the Export-Import Bank into the kind of box that I think that the definition of CBO could well place it.

And that's why I'm very hopeful that in your Budget Committee, you will see the CBO position seriously considered, but perhaps not prevail.

Chairman NEAL. Well, let me just make another point along these lines.

Mr. LEACH. Yes.

Chairman NEAL. We were asked by the committee to make a recommendation to them to be forwarded to the Budget Committee concerning the level of funding, the level of authorized activity for the direct loan program of the Eximbank.

We sent along a recommendation for $1.8 billion. According to an analysis which I believe came from the Congressional Budget Office, at that level we would show a positive cash-flow of something like $680 million. That would reduce the overall budget deficit in real terms by that amount.

Now I know it's a bit more of a complicated argument to make, but I would hope that we could make that argument with our colleagues and point out that this has been historically a money making operation and it serves the national interest and so on. We certainly hope that we can do that.

I share my colleague's concern that it might be difficult, but I certainly hope that we can. It's clearly a legitimate case and I hope that we can make that case. We always have been able to in the past. I hope we can continue to.

You know, if we fooled around with the budget, I am sure we could find ways to reduce the deficit to zero. We could take the defense budget off budget, for example. We could do it by loan guarantees or something.

That would be clever. Maybe we ought to consider that.

Mr. Chandler.

Mr. CHANDLER. Thank you, Mr. Chairman.

Mr. Blum, the testimony that you provided in advance, and I appreciate that because I had a chance to study it before you came here, one sentence, or one paragraph on page 2, the third one there, really struck me as being key to this whole debate, and the gentleman from Iowa, I think, was trying to tug you in one direction on that.

Candidly, I am going to try to tug you in another.

Where you are saying that direct loan disbursement by Government during the fiscal year is treated as equivalent in budget cost to equal dollar expenditure for grants or salaries and wages. This treatment is faulty because loan repayments are expected and these repayments reduce the real cost of the loan outlays. And I very much agree and it's clear, I believe, that the committee members agree also.

But having said that, then if you apply essentially the logic that you did to the I-MATCH Program, then I am wondering why you don't also apply it to the direct loan program since it seems like we are not comparing apples and oranges, but almost California oranges and Florida oranges here, that if the logic applies, that there's far more budget impact with the I-MATCH Program than OMB would claim. Then given your statement here, why don't we agree with OMB, but say the same thing of both programs?

Mr. BLUM. Mr. Chairman, what I was attempting to do with that paragraph is to state our very clear reservations with the present budgetary treatment of all credit programs. This treatment derives from practices that were put into place almost 20 years ago, deriving from the President's Commission on Budget Concepts.

If we had our druthers, if we could change the whole budget treatment for credit programs, we would try to—we would move in

the direction of recording on budget the direct subsidy costs for loan programs as well as for loan guarantee programs. And that would put these credit programs on an equivalent basis with the direct spending programs.

If we had a new Presidential or Congressional Commission on Budgetary Concepts, for example, that would be our recommendation. But we are not dealing with that situation right now. We are dealing with the existing budgetary treatment, which does have this deficiency, as laid out in my statement. And what that deficiency offers, I suppose, is the temptation to take advantage of it and to shift a direct lending program to a 100-percent loan guarantee with an interest subsidy, which is not really changing the nature of the program at all, but merely taking advantage of a loophole in budget accounting practice.

Mr. CHANDLER. Mr. Chairman, I will ask Mr. Blum, but if you are more appropriately the one to answer, please feel free to do so, because I don't know yet. Who makes the decision between OMB and CBO in this dispute? Who ultimately decides how we score?

Chairman NEAL. I believe our own Budget Committee is the final authority. Is that not correct, Mr. Blum?

Mr. BLUM. I think that is correct. Under the Congressional Budget Act, as amended by the Balanced Budget Act or the Gramm-Rudman-Hollings Act, it is clear that the Budget Committees are the principal source of guidance to the parliamentarians as to how actions are to be scored vis-a-vis a budget resolution.

Chairman NEAL. It is also my understanding that the chairman of the Budget Committee has indicated that he intends to follow the advice of the Congressional Budget Office.

Is that not also correct?

Mr. BLUM. I——

Chairman NEAL. He hasn't said that to me. I have just heard that he said that.

Mr. BLUM. Well, I don't know that for a fact, Mr. Chairman, but that may be so.

Chairman NEAL. Well, doesn't he and the other members of the committee pretty much rely on all of you as their authoritative source?

Mr. BLUM. Yes, that is correct.

Chairman NEAL. I hope so. It's my understanding that you are a nonpartisan, and I believe highly respected, independent organization and that your predictions concerning economic behavior and the cost of various programs and so on have been considerably more accurate than that of the Office of Management and Budget.

I am not asking you to comment on that, but that's certainly my understanding. I have certainly found that I trust what you all turn out much more. I have found the Office of Management and Budget often to be very political in its projections and I think you all have risen above that.

Mr. BLUM. Our mandate is to be a nonpartisan, objective staff to serve the information needs of the Congress. We try very hard to do that.

Mr. CHANDLER. The decision, then, assuming that the Budget Committee does look to CBO, and perhaps to us, Mr. Chairman, would your advice, then, be to us to take a very careful look at that

third paragraph on page 2 and perhaps discuss with the Budget Committee the reconsideration of the treatment of the Direct Loan Program in light of how we treat it as affecting the budget deficit, and more realistically appraise it with its impact?

Mr. BLUM. I would think that that should not be done in isolation with just the Eximbank programs.

Mr. CHANDLER. No.

Mr. BLUM. It should include all credit programs. But I would not think that that would mean a marked change in the budget treatment for these programs and I presume——

Mr. CHANDLER. But according to your testimony, more realistic.

Mr. BLUM. Absolutely. No question about it, in terms of putting the credit programs on a comparable basis with direct cash outlay-type spending. But I would point out that the balanced budget targets as set forth in the Balanced Budget Act were based on the present accounting framework, and so the Congress might want to consider altering those targets in some way if there were to be a major change in budget accounting.

Mr. CHANDLER. We might make it worse or we might make it better. I'm not sure which.

Well, those are all the questions I have, Mr. Chairman. Thank you.

Chairman NEAL. Thank you, sir. Mr. Levin.

Mr. LEVIN. Let me just follow up because I think your line of questioning suggests this further question.

We may be dealing with the heart of this proposal because if there is no budget deficit saving, it may well be dead. So I think we should understand what is being said.

I think, to follow up Mr. Chandler's question, it might be argued that to shift it from loan to guarantee under present practice would reduce the deficit, and this is the argument that I think would be made.

And while it would be better to have a comprehensive reform so that loans are treated the same way as guarantees, with less of an impact on the budget, pending that comprehensive reform, why not take advantage of what you earlier called a loophole and implement a change that would reduce the deficit in part when a comprehensive reform would reduce the deficit even more.

In lay language, I think maybe that would be the argument backed by the administration.

So it isn't sound accounting practice to do it this way, but pending the implementation of sound accounting practices that would reduce the deficit even more than this $2 billion by treating loans and guarantees more equivalently across the board, why not do it piecemeal?

Mr. BLUM. That would be something, I believe, for the Congress to decide. As you know, CBO does not get involved in making policy recommendations——

Mr. LEVIN. No, that's not policy. It relates to your testimony, I think directly. As I understand your position, in simple English, this attempts to treat guarantees different from loans. They really should be treated more equivalently. If they did, there would be broader reductions in the way the deficit is calculated.

So, then, a kind of practical response to that is, pending the more comprehensive change which would lower the deficit, why not take advantage of present accounting procedures and simply do so and thereby, lower the deficit, which we ought to do anyway, through a more basic accounting reform?

Or am I missing something? It seems to me that this picks up your question.

Mr. BLUM. I think what is guiding us here is simply that the proposal, as presented to the subcommittee earlier this month, really makes no change in substance in the present Direct Lending Program. It conveys the same subsidy. It just merely shifts the source of financing from the Federal Financing Bank to the private sector.

In the past, this type of activity has, for more than 20 years, been treated as a Direct Loan Program, and the private financing is just considered agency debt, involved in financing the Direct Fund Program.

What we are saying here is that since there is no change in the nature of the program, it should be scored in a manner consistent with how the budget now treats direct loan programs.

Mr. LEVIN. Except you seem to be saying that it's consistently wrong. So this proposal is saying, to play the devil's advocate, let's be inconsistently right. It seems to me that that's at least a possible critique of your testimony.

So, especially when it's important to lower the deficit, isn't inconsistently right better than consistently incorrect?

Mr. BLUM. I find it very difficult to respond to that.

Mr. LEVIN. I don't know why, though, because you are not—excuse me—you are not an accountant. We are not talking here about——

Mr. BLUM. I think it almost goes in the direction of two wrongs don't make a right. The fact is that loan programs aren't treated correctly, and it's also true that loan guarantee programs aren't treated correctly.

I think our basic point is that the OMB Circular A-70 sets forth a set of criteria for judging credit proposals, whether they are coming from the administration or from the Congress. We think the circular is a very good set of guidelines for looking at credit proposals under existing budgetary treatment.

This proposal, as supported by the administration and, apparently, by OMB, is contrary to that circular.

Mr. LEVIN. Well, in part, and I am not an expert on Circular A-70, but as I read your testimony, its thrust is to avoid conversion on 100 percent basis, and it says here, suggests that private lenders be required to assume at least 20 percent of the loss from default.

That may be more the thrust of it than the prohibition on illusory budget savings. But I am not sure of the background of that. You say two wrongs—again, I think we need to understand this because this is really the critical point in this legislation.

Without a budget saving, I think this legislation is dead, at least in a comprehensive way. That is my judgment. A pilot project is something else, perhaps.

You say two wrongs don't make a right. The devil's advocate response might be—OK, but if you can remedy part of the wrong in practice, don't get all caught up in theory.

And I don't see from your testimony the public policy argument, except consistency. And I won't quote Shakespeare on consistency. But the argument is that it's foolish if you can save $2 billion to throw it away, simply so that you can say that you treated everything consistently, albeit, wrongly.

And it seems to me you need to answer that; that isn't outside the role of CBO to answer that comment that I am sure will be coming from the administration, especially in view of your testimony, your statement about comprehensive reform, that the true cost to the Government is its subsidy.

Mr. BLUM. Maybe——

Mr. LEVIN. How many loans—we are talking about a huge amount of loans, of direct loans that are scored directly as an outlay, as an expenditure? Are we talking about billions and billions of dollars here?

Mr. BLUM. Yes, there are billions and billions of dollars of direct loans.

Mr. LEVIN. Tens of billions?

Mr. BLUM. Well, the net effect with respect to the deficit is that total outlays are offset by loan repayments, so that the net effect is not terribly large.

Mr. LEVIN. So if there were this comprehensive reform that you imply might be in order, we would not see a reduction in the deficit by tens of billions?

Mr. BLUM. No; I don't believe so. We haven't done any specific calculations to see how the budget numbers would work out.

Mr. LEVIN. I think, like Mr. Chandler, I am a bit hesitant to ask for it because I think we ought to keep the heat on instead of taking it off on the deficit. And I'm afraid you could throw another straw that a lot of people might grab at. But I want to know the facts. Why don't you give us the facts as to what might be the impact if the accounting procedures were changed, as you suggest on page 3?

Mr. BLUM. We did some analysis along those lines a few years ago and we could take a look at that and try to update it.

Mr. LEVIN. Could you do that? Thank you.

Chairman NEAL. Mr. Levin——

Mr. LEVIN. No; it's not for Exim.

Mr. BLUM. Across the board. No; I understand.

Mr. LEVIN. Across the board.

[In response to the request of Congressman Levin, the following information was submitted ro the record by Mr. Blum:]

REPLY RECEIVED FROM MR. BLUM

Substituting credit subsidy costs for cash-flow costs in the federal budget would improve the information used by the Congress in allocating federal resources. It also has some potential for reducing outlays and the deficit in the short term. Whether such a reduction is achieved depends on how this substitution is effected.

Subsidy costs may be substituted for cash-flow cost through changes in accounting (the "Appropriations plan") or through loan sales and reinsurance of guarantees (the "Market plan"). Total government outlays and the deficit will be affected only if some variation of the "Market plan" is adopted. That plan calls for the competitive sale without recourse to the government of loan assets and the reinsurance of guarantees with private companies. The allocation of costs across accounts, however, could be changed markedly by the "Appropriations plan," which requires the establishment of a government loan fund account to which all loan advances and repay-

ments would be charged and credited. New loans made by Eximbank—which is used as an example throughout this discussion—would show a budget "cost" of only $.064 per dollar loaned rather than $1 per dollar loaned under this account restructuring.

BACKGROUND

The current budgetary treatment of federal credit programs fails to provide the Congress with meaningful, expenditure-equivalent measures of cost. Both direct loans and guarantees are scored in the cash-based budget in terms of current-year cash disbursements. For direct loans, the cash-flow cost is the dollar volume of loans disbursed less repayments credited to that account in that particular fiscal year. For guarantees, the cash-flow cost is zero until a default occurs. In fact, fee income can make costly guarantees appear profitable when issued. For new direct loan disbursements, current budget treatment overstates the value of resources permanently conveyed to beneficiaries by the credit transaction. For new guarantee commitments, current treatment understates this value and its cost to the government.

A more appropriate measure of cost for Congressional allocative decisions is subsidy cost. For direct loans, subsidy cost is the present value of the government's negative interest spread, the expected loss from defaults, and capital and administrative costs for current-year obligations. Subsidy cost for guarantees is the present value of expected defaults and capital and administrative costs for current-year commitments. In almost all cases, subsidy costs are less than the full amount of the loan but greater than the zero attributed to guarantees.

EXIMBANK IN THE BUDGET ACCOUNTS

For FY 1985, Eximbank contributed a negative $384 million to federal outlays and the deficit. This means that total receipts of interest and principal, fees, and recoveries exceeded loan disbursements and other outlays. Eximbank net outlays are projected to remain negative (net cash inflows) for 1986 and 1987 under current policy.

Each dollar change in lending by Eximbank has an equal dollar effect on federal outlays and the deficit in the year disbursed. The subsidy conveyed by Exim lending, however, is far less than the dollar disbursed. OMB estimates these subsidy costs for Eximbank at 6.4 cents per dollar on direct loans and 3.8 cents per dollar on guaranteed loans. If we could substitute subsidy costs for cash-flow costs in the budget, changes in Eximbank direct loans would have a smaller and guarantees a larger effect on budget costs than under current policy.

If subsidy costs were substituted for cash-flow costs, Eximbank credit assistance would always contribute an increase to budgetary outlays and the deficit. That is, just as Eximbank would never be charged for loan disbursements, it would never be credited with repayments. If it loaned $1 billion and guaranteed $1 billion in a particular year, it would be charged with subsidy costs of $64 million for the direct loans and $38 million for the loan guarantees, or $102 million (given the OMB estimates of subsidy costs).

SUBSTITUTING SUBSIDY COST FOR CASH-FLOW CREDIT COST THROUGHOUT THE BUDGET

If subsidy cost were substituted for cash-flow cost, the measured cost of federal credit across programs and over time would be significantly affected. To obtain a rough estimate of the aggregate effects of such a change, compare 1984-85 net lending to OMB's estimate of subsidy costs for these years. Net lending for 1984 and 1985 was $6.3 billion and $28 billion, respectively. Credit subsidy costs as estimated by OMB totaled $15.7 and $16 billion in those years. For 1984, therefore, the change to subsidy costs would have increased credit cost by $9.4 billion. In 1985, the effect would have been to reduce credit cost by $12 billion.

This result (increase one year, decrease the next) may seem surprising given that subsidy cost is almost always less than the cash-flow disbursement cost of direct loans. The effects of fluctuations in repayments relative to disbursements, however, have been removed from the measured cost of credit assistance.

The government's total borrowing requirement would not be reduced necessarily by this change. If this change in recognized cost were put in place by accounting changes alone, no reduction in total government outlays, borrowing requirement, or the deficit would be realized. In 1985, for example, credit assistance would have been charged with $16 billion in subsidy costs. This $16 billion would have been financed by Treasury. Net lending, however, was $28 billion—or $12 billion more than subsidy costs. This additional $12 billion would also have been financed by Treasury. Thus, Treasury borrowing would have been $28 billion for credit after the adoption of subsidy cost. This result makes sense because only accounting changes

would have been made: government would still have had to finance it cash-flow needs.

IMPLEMENT CREDIT COST REFORM: SEPARATING FUNDS FLOWS FROM SUBSIDY COST

The essence of this budgetary reform is to separate pure financial flows from subsidies conveyed. One means of obtaining such a separation is to establish a government entity to which all credit-related cash-flows would be charged and credited. For example, as discussed in "New Approaches to the Budgetary Treatment of Federal Credit Assistance," pp. 52-56, a National Loan Fund could be established to disburse loans, receive repayments, and issue and honor guarantees, entirely at the direction of existing credit agencies such as the Eximbank.

The Fund would finance its disbursements through repayments and borrowing from the FFB and its losses and operating expenses through full-cost loan and guarantee subsidy fees charged by the Fund to the directing agencies. Thus, the Fund might issue $1 billion in loans at the direction of Eximbank for which it would charge Exim $64 million. In 1985, for example, the Fund would have collected $16 billion in subsidy fees from all the credit agencies (accepting OMB's estimate of subsidy costs as correct). It would have disbursed net loan funds of $28 billion (net lending for 1985). The Fund would finance loans from appropriated subsidies to the extent possible, with the remainder ($12 billion) to be borrowed from FFB. Total government disbursements for credit (subsidies and financing) would be the same as before the Fund was established, $28 billion.

Nonetheless, individual loan programs, such as Eximbank, would be charged only for the subsidies provided, not for loan funds disbursed.

SOME DIFFICULTIES ASSOCIATED WITH A NATIONAL LOAN FUND

As discussed in "New Approaches", the usefulness of a government loan fund would depend to a large extent on the ability of such a Fund to accurately estimate the subsidy costs of federal credit programs. Doubts about the ability of government to perform this task have led some proponents of credit accounting reform to favor the "Market plan," also described in "New Approaches." Under this proposal, agencies would continue to originate loans and issue guarantees, but they would be required to sell the loans in the open markets and reinsure guarantees with private firms. The market discount from the face value of the loan and the reinsurance premium would provide a cash-based measure of subsidy costs. These costs would be appropriated annually by the Congress. The deficit would decline by the net proceeds from loan sales and insurance premiums paid by government. Preliminary projections show that the "Market plan" would reduce deficits for several years. In the outyears, however, deficits would be somewhat larger than projected under current policy.

Mr. BLUM. I would point out, however, that the net impact here on the deficit with respect to 1987, even under the administration's proposal, is only two-tenths of a billion dollars. I mean, it's not a $2 billion proposal.

Mr. LEVIN. Except, if you are talking about the goal of reduction to a certain level, it's much larger in the out-years.

Right?

Mr. WHITEHILL. It's about $900 million.

Mr. LEVIN. $900?

Mr. BLUM. $900 million.

Mr. CHANDLER. Cumulative.

Mr. BLUM. Yes.

Chairman NEAL. Isn't it true that by sticking with the Direct Loan Program, we have a significantly more positive effect on cash flow and reduction of the budget deficit than going to the I-MATCH Program?

Mr. BLUM. It certainly is less costly to the Government, in the sense that it is more costly to finance it from outside the Treasury and the FFB.

Mr. LEVIN. Is that figure agreed on? It's clearly more costly—Mr. Chairman, I don't know if there's ever been agreement on how much it would be. It's not insignificant.

Chairman NEAL. Well, in the testimony, on page 1, at the end of the first paragraph, you say, "whereas OMB credits this proposal with a reduction in 1987 outlays and the deficit of $0.2 billion, in our analysis of the President's budget, we estimated that the proposal would increase outlays $0.1 billion."

Mr. LEVIN. By $100 million.

Chairman NEAL. Well, anyway, back to a point that Mr. Levin made, and I would rather that you characterize it. You said something—I think you indicated that you thought that there had been an inconsistency in this all along.

What did you say? I'm trying to remember. It struck me that your comment might not be agreed to by Mr. Blum.

Mr. LEVIN. No. His position seems to be that if one is consistent, there's no basic budget savings. The argument would be that, all right, that's true. But the inconsistency that reduces the deficit is better than consistency that increases it, just to reiterate what I said.

Now I do think that the linchpin of this proposal from the very beginning has been projected budget savings. I think the Exim has been blunt enough to say that this proposal was in response to proposals to cut direct lending because of the threat of the Budget Act, that if there hadn't been this terrible crunch, this proposal probably would not be here because it costs more to go to the private market than it does direct loans.

And so there seems to be no other advantage than the budget savings, right? I don't think we have heard any contrary testimony, have we?

Chairman NEAL. Well, only to say that a banker testified yesterday that he would prefer the Loan Guarantee Program and suggested that it would be more effective.

The overwhelming majority of our witnesses have suggested that they think the Direct Loan Program is less expensive, more effective, tried and true, and so on. But I have to say that there has been——

Mr. LEVIN. Bankers, and I understand financial institutions would like it. I am talking about public policy.

Chairman NEAL. No. I think you are absolutely correct. The Chairman of the Eximbank has said a number of times that I-MATCH is less expensive. But there is absolutely no evidence to support it, which we have pointed out every time we've had testimony on the subject from the very beginning. And now the Congressional Budget Office has again pointed out that this program will cost more money. And of course, it's untried. We don't know if it will work or not.

Now I am not saying it won't. In fact, I think myself that we ought to have a pilot program because there may come a time when we would need something like this. But there is just absolutely no doubt that the original assertion that by shifting this program, it's going to save us several billion dollars in the budget deficit, is just absolute nonsense. It's smoke and mirrors. It's deceptive and we shouldn't let that kind of assertion stand unchallenged.

Mr. CHANDLER. Mr. Chairman.

Chairman NEAL. Yes.

Mr. CHANDLER. Thank you for yielding. I really agree with your statement. The problem is today, probably, I think we have just had outstanding testimony here. And up to a point, we've had the right witness. Now we have the wrong one because what I am suggesting is that we ought to apply OMB's logic consistently. And I think that's what——

Chairman NEAL. Throughout the entire budget process.

Mr. CHANDLER. Exactly.

Chairman NEAL. Suits me. I would vote for it.

Mr. CHANDLER. And say, OK, if your I-MATCH Program has this lesser budgetary impact, then so does the Direct Lending Program. We have been miscalling it all along, that the mistake has been there all along and you don't just correct it by creating another new program. You correct it consistently.

That's the point that I was trying to make.

Chairman NEAL. Well, I am not following that point. What's been the problem with the Direct Loan Program?

Mr. CHANDLER. That we have overestimated its budget impact.

Mr. LEVIN. We should just include the subsidy and not——

Mr. CHANDLER. I'm willing to concede——

Chairman NEAL. Well, I think that's what happens, in the final analysis. That is what's included, isn't it, in the Direct Loan Program?

Mr. CHANDLER. No. See, I am willing to concede that OMB is right on I-MATCH. But if they are right on I-MATCH, then they are wrong on the Direct Loan Program and have been consistently. And that the Direct Loan Program has no more budgetary impact, deficit impact, than would be I-MATCH Program.

Mr. LEVIN. Anyway, why don't we see the figures because I am not sure as an accounting matter you carry only the subsidy and not the full extent of liability. There's no reflection for potential liability under sound accounting principles.

Mr. BLUM. If we had our druthers, we would like to see a budgetary treatment for credit programs that would focus on the subsidies involved, including interest subsidies, protection against defaults, and the like. It seems to me we would then have a comparable basis for viewing this against other proposed ways of providing a subsidy.

If we had credit programs in a preferred budgetary treatment, I think the present proposal would turn out to be more costly, vis-a-vis relying on Treasury and FFB financing. The interest subsidy conveyed is more costly.

Chairman NEAL. In the final analysis, doesn't the budget reflect the cost of the subsidy element?

Mr. BLUM. No. The budget, as it stands now, is very much a cash-based budget. It is cash disbursements versus cash receipts, and the reason is that the focus is primarily on financing. That helps to isolate the financing of budget disbursements, showing how much comes from tax receipts, on the one hand, and how much from borrowing from the private credit markets.

From that vantage point, this proposal does not lessen in any way whatsoever the amount of Government reliance on private

credit to finance its programs. It's merely shifting borrowing that the Treasury does in the private credit markets to Eximbank doing it directly.

In that sense, there's no economic change whatsoever.

Mr. LEVIN. The increased cost is because it costs more to do it vis-a-vis—it costs more to go to the private sector kind of ad hoc for these loans than it does for the Treasury to borrow en masse. I mean, that's essentially the difference.

Mr. BLUM. That is correct.

Mr. LEVIN. Well, Mr. Chairman, we are going to receive this report. Maybe this is further impetus to take a whole look at the accounting procedures. This isn't the first time that the issue has been raised, but it's a vivid illustration of the problem.

I appreciate your indulgence, letting us go back and forth this way.

Chairman NEAL. May I ask this question? I haven't looked at this in some time and I don't remember.

What is the net impact of the Eximbank Direct Loan Program on the budget as it is now treated?

Mr. BLUM. At this present time, the net impact on the budget, given the administration's budgetary proposals, is a net negative outlay, because loan repayments are exceeding disbursements. In that sense, the Eximbank is already contributing to a lower deficit, on a cash flow basis.

Chairman NEAL. So when you consider the budget outlay category, there is a positive contribution by Eximbank.

Mr. BLUM. At this point in time, yes, sir.

Chairman NEAL. And is that not projected to be the case for the next several years?

Mr. BLUM. Yes.

Chairman NEAL. Now you say, when you began your answer, you qualified it in some way. You said, according to the——

Mr. BLUM. That was in terms of viewing the I-MATCH proposal as equivalent to——

Chairman NEAL. No, no. I am not talking about I-MATCH. I am talking about the Direct Loan Program.

Mr. BLUM. I am sorry. That's equivalent to a Direct Loan Program of new direct loans of $1.8 billion.

Chairman NEAL. Maybe I am not putting my question very well.

Leaving I-MATCH entirely out of it, what is the impact of the Direct Loan Program, the way it is treated now for budgetary purposes, on the deficit situation?

Mr. BLUM. I guess I am not completely sure I understand your question, Mr. Chairman. In terms of the cash-based budget treatment as it stands right now, as I indicated earlier, we have net negative outlays assigned to the Eximbank.

Because of the minus sign, these are recorded as negative outlays. It reduces total outlays and, therefore, the deficit. Now these negative outlays result simply from the fact that loan repayments are currently exceeding new loan disbursements.

Chairman NEAL. Well, let's see—OK. That's my understanding. We have requested a level of $1.8 billion in direct loan authority for the Eximbank. And we understand, from your analysis, that

that would generate a positive cash flow of about $680 million—not that that would generate it, but that at that level——

Mr. BLUM. That would leave Eximbank in that situation for the fiscal year, yes, sir.

Chairman NEAL. Mr. Chandler, do you have anything else?

Mr. CHANDLER. No. The only thing that I think we need to go back to is the point that your staff pointed out to me. It would take an amendment to the Budget Act to change the treatment of the Direct Loan Program if we were to decide to do that. I think you pointed that out earlier.

Mr. BLUM. I am not sure exactly how—that could well be an implication. I am not sure exactly.

Mr. CHANDLER. I think, as I quickly read it, it does treat a Direct Loan Program as a cash outlay; whereas, the guarantee, it treats it differently, only whatever subsidy there would be.

Under the definition, the terms, "budget outlays" and "outlays" mean with respect to any fiscal year expenditures and net lending of funds under budget authority during such year.

Thank you, Mr. Chairman.

Chairman NEAL. Thank you, sir. Let me thank Mr. Blum and his associates for coming this morning.

Mr. BLUM. Thank you.

Chairman NEAL. We appreciate your help with this very much.

The subcommittee stands adjourned, subject to the call of the Chair.

[Whereupon, at 11:12 a.m., the subcommittee was recessed, to reconvene subject to the call of the Chair.]

[The following statement was received by the subcommittee for inclusion in the record:]

Statement of Mr. James J. Galvin
Chairman of the Board and Chief Executive Officer
Phosphate Rock Export Association
Tampa, Florida

before the

Subcommittee on International Finance,
Trade and Monetary Policy
Committee on Banking, Finance
and Urban Affairs
United States House of Representatives

regarding

Reauthorization of the Charter of the
Export-Import Bank of the United States

Statement of Mr. James J. Galvin
Chairman of the Board and Chief Executive Officer
Phosphate Rock Export Association
Tampa, Florida

Mr. Chairman, distinguished members of the Subcommittee on International Finance, Trade and Monetary Policy, I am pleased to appear today to provide the views of the Phosphate Rock Export Association ("Phosrock")[1/] on the reauthorization of the charter of the Export-Import Bank of the United States (the "Eximbank"). Phosrock is pleased that the FY-1987 budget which the Administration has submitted calls for the elimination of direct loans from the Eximbank which had increased from $660 million in the FY-85 budget to $1,062 million in FY-86. Nevertheless, Phosrock is seriously concerned about the proposed substantial increase in Eximbank guaranteed loan authority which has grown from $7,849 million in FY-85 to $12,000 million in the proposed FY-87 budget.

We urge this Subcommittee to give careful consideration to this matter. Quite often, the lending practices of the Eximbank have done more harm than good. In particular, Phosrock submits its view that the misguided financing program of the Eximbank for the benefit of Phosrock's principal overseas

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[1/] Phosrock, headquartered in Tampa, Florida, is the export sales agent for Agrico Chemical Company, AMAX Chemical Corportion, Freeport Phosphate Rock Company, Gardinier, Inc., International Minerals & Chemical Corporation, Mobil Mining and Minerals Co., Occidental Chemical Company and W.R. Grace & Co. The Association accounts for roughly ninety percent of U.S. phosphate rock exports.

competitor, Morroco's Office Cherifin des Phosphate (the "OCP"), has had a serious negative impact on the U.S. phosphate industry.

Since 1980, then a time of serious economic recession and overcapacity in the phosphate industry, Phosrock has sought to change the misguided policy of the Eximbank to promote Morocco's ambitious phosphate development program. The economic consequences of this policy are particularly significant to the thousands of domestic phosphate company employees and to the tens of thousands of other men and women whose jobs are dependant on the American phosphate industry. Because of the continued refusal of the Eximbank to confront the real economic consequences of its financing policies, the health of American phosphate industry has deteriorated even further from its position at the beginning of the decade.[2/]

[2/] This Eximbank attitude of seeming indifference to U.S. domestic phosphate industry interests appears to have been hardened when the U.S. Department of Commerce in 1981 suggested that the U.S. industry invest in Morocco's phosphate development, stating:

> The Moroccan Government has embarked on a major expansion of its phosphate mining and acid processing facilities. Approximately $5 billion will be spent by the Moroccan Government on phosphate processing and related infrastructure development during the five-year period, 1980-1985. I encourage you to consider the business opportunities that may be appropriate for your firm.

The Department's policy is stated as consistent with the U.S. - Moroccan commitment to strengthen commercial ties between the Country. An exemplary copy of the Commerce letter is attached as Exhibit A.

In 1980 and 1981, the Eximbank authorized loans totaling approximately $90 million to Morocco's OCP. While OCP purportedly used these "facilities" to finance the purchase of U.S. goods and services for mining and chemical projects, receipt of these grants freed up other funds which Morocco used for other purposes such as credit subsidies for phosphates sold by it to customers of both Phosrock and OCP, for example, Poland and Romania. The U.S. phosphate producers' lack of similar financial assistance disadvantaged them in competing with OCP in international markets, including Eastern Europe. These loan facilities to assist the OCP have continued and resulted in a further $15 million grant in 1985. These Eximbank loans have had a serious negative impact on the U.S. phosphate industry which has closed mines and laid off workers. Phosphate industry employment has dropped from 10,000 in 1981 to 5,000 today.3/

In light of this fact, it is particularly ironic that the Eximbank authorized the 1980-81 loans to Morocco after "finding" that no U.S. industry would be injured by these substantial grants.4/ This determination was made without

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3/See U.S. Dept. of Interior, 1985 Minerals Industries Survey: Phosphate Rock (1986 Preliminary), a copy of which is attached as Exhbit B.

4/Copies of the economic impact statements by the Bank for each of these loans were obtained under the Freedom of Information Act and are attached hereto as Exhibit C.

any notice to the phosphate industry and other government agencies who were neither notified of OCP's applications nor given an opportunity to comment on them. The Bank concluded that U.S. phosphate exports will decline after 1985 and that the United States must develop a strong Moroccan industry in order to assure the future availability of Moroccan phosphate rock to satisfy U.S. demand, stating as follows:

> In the short term, the expanded Moroccan sales may compete to some extent with U.S. exports in third country markets. However, given the growing demand, it is unlikely that U.S. sales will be displaced to any significant extent. In the long term, development of the Moroccan resources is in the best interest of the U.S. With U.S. production declining, the existence of a healthy phosphate industry in Morocco is essential to insure the continued supply of a critically important agriculture chemical.

None of the Bank's ultimate conclusions are correct.

In support of its conclusion, the Eximbank relied on a 1979 General Accounting Office Report, Phosphate: A Case Study of a Valuable, Depleting Mineral in America, as the only source of its information on the phosphate industry. This report has been widely criticized for grossly underestimating U.S. phosphate supplies and overstating concerns about the future availability of phosphates. The GAO Study sets forth the unqualified opinion that U.S. phosphate exports will decline after 1985. In the industry's view, there are hundreds of years of phosphate supply available in the United

States to meet domestic needs and make a positive contribution to world export trade.

The premise of the Eximbank's action is that declining U.S. phosphate rock supplies require that U.S. phosphate exports decline after 1985 and that a Moroccan industry be developed to permit imports to satisfy domestic demand. As has been repeatedly demonstrated, the concerns about adequate phosphate resources are greatly exaggerated.5/ Nevertheless, these very lending activities have caused the U.S. industry to suffer the consequences which the supposed depleted resources were to cause. Creation of a competitive foreign phosphate industry will dry up U.S. export opportunities. Indeed, in addition to the Eximbank loans, the World Bank has long been very active in lending for new foreign phosphate facilities:

1. 1980, a $7.5 million feasibility study to Peru to develop the Bayovar phosphate deposits. The loan rate was 10% or less.

2. 1981, a $5.7 million loan to Togo to determine the feasibility of developing a new phosphate rock deposit and construct a phosphoric acid plant.

3. 1975-76, a $110 million loan to Turkey to modernize and debottleneck phosphoric acid plants at 9-10% interest.

5/ According to the Interior Department, U.S. phosphate rock resources are "very large." Report, Task Force on Availability of Federally Owned Mineral Lands, U.S. Department of the Interior, 1977, p. 39. Major unexploited resources are presently available on federal lands. Current reserve levels are now estimated to be 4,000 percent higher than they were estimated 30 years ago.

4. 1975-76, a $40 million loan to Morocco for a phosphoric acid plant at Maroc Phosphore I.

5. 1976-80, a $40 million study to improve distribution of fertilizer in Morocco.

6. 1978, a $70 million loan to Jordan at 9 or 10% interest for a phosphoric acid complex.

7. 1977, an $82 million loan to Brazil for the Valle Fertil phosphoric acid and triple superphosphate plant at 9-10% interest.

8. 1974-78, a $100 million loan to Morocco to construct a fourth phosphoric acid line for Maroc Phosphore I.

9. 1980, an $11 million loan to Egypt for a feasibility study and equip an experimental mine at Abu Tartar.

10. 1974, a $23 million loan to Tunisia to develop a new phosphate rock mine.

These activities sought to assist the development of an overseas phosphate industry competitive with our severely depressed U.S. industry. Having received low-cost financing and being strategically located near the U.S. industry's traditional overseas customers, Phosrock's competitors are being strengthened and more likely than depleting resources will cause substantial reductions in important U.S. phosphate export trade.

Yet, the results of these activities have had even a further ironic twist. Not only has the lending activities of the Eximbank had a serious negative effect on the U.S.

phosphate industry but also these expansionest activities may even have harmed OCP, the intended beneficiary. Despite warning from the U.S. industry, this process has developed a world phosphate rock industry with a substantial supply/demand imbalance extending to the end of the century. This is graphically illustrated by official 1986 U.S. Government data[6] as follows:

	1985	1990	1995	2000
World Phosphate Rock Capacity (million t/a)	178.7	211.7	236.5	243.2
World Phosphate Rock Demand (million t/a)	160.0	189.0	217.0	253.0

While Eximbank justifies its actions on the ground that if it did not lend money to overseas phosphate producers someone else would,[7] such overcapacity that has resulted from these actions has only served to depress an industry whose health is vital to the essential food production process around the world. Indeed, the world industry faces possible long term oversupply, lower prices and lower revenues that may make it very difficult for the recipients of such Emibank/World Bank financing to repay the loans when they become due.

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[6] U.S. Department of Interior, Phosphate Rock: World Resources, Supply and Demand (1986).

[7] It is the logic used by a bartender to serve an obviously drunk patron who is grossly inebriated and needs nothing further to drink. The bartender makes the assumption that if he doesn't serve (give him the loan) the drunk person (who has tremendous excess capacity), the patron will only go somewhere else and get the drink (money) he desires. Therefore, why not serve the patron. That is the Eximbank's argument.

Exhibit A

UNITED STATES DEPARTMENT OF COMMERCE
The Under Secretary for International Trade
Washington D.C. 20230

JUL 6 1981

Mr. D. W. Calvert
Chief Executive Officer
Agrico Chemical Company
One Williams Center
P.O. Box 3166
Tulsa, Oklahoma 74101

Dear Mr. Calvert:

In keeping with our policy to promote U.S. exports, the Department of Commerce supports increased U.S. business participation in the Government of Morocco's ambitious phosphate development program. This policy is consistent with the U.S.-Moroccan commitment to strengthen the commercial ties between the countries.

The Moroccan Government has embarked on a major expansion of its phosphate mining and acid processing facilities. Approximately $5 billion will be spent by the Moroccan Government on phosphate processing and related infrastructure development during the five year period, 1980-1985. I encourage you to consider the business opportunities that may be appropriate for your firm.

I understand that the Justice Department's investigation of the phosphate industry may have caused concern among U.S. firms regarding the legality of further involvement with Morocco's Office Cherifien des Phosphates (OCP) and with the Institut Mondial des Phosphates (IMPHOS), the Moroccan sponsored international forum for exchange of technical information on phosphates. That investigation was closed in 1978 and no further investigations are contemplated presently.

The Justice Department has advised me that there is no obstacle which precludes U.S. phosphate producers from pursuing legitimate business relationships with the OCP, or from participation in IMPHOS, other than the usual antitrust considerations that normally apply to any cooperative undertaking. As with any joint venture, industry or trade association activity, we suggest that you consult with your antitrust counsel for appropriate guidance.

The Department of Commerce will follow closely the developments in Morocco's phosphate program and we will be pleased to keep you informed of new business opportunities. Should you need additional information, please contact Ms. Helen Mak, the Project Officer for this activity, with the Commerce Action Group for the Near East (CAGNE). Ms. Mak may be called at (202) 377-4441.

Lionel H. Olmer

Lionel H. Olmer

Exhibit 8

MINERAL INDUSTRY SURVEYS

U. S. DEPARTMENT OF THE INTERIOR
BUREAU OF MINES
WASHINGTON, D.C. 20241

Donald Paul Hodel, Secretary — Robert C. Horton, Director

For information call William F.Stewasser
Telephone: (202) 634-1190

Annual, Preliminary

PHOSPHATE ROCK IN 1985

The attached 2 pages reprinted from the Bureau of Mines Mineral Commodity Summaries--1986, provide the earliest estimates of 1985 data and activity highlights on Phosphate Rock. Most of the estimates are based on 9 months data and are compared with final data from previous years.

Prepared in the Division of Industrial Minerals, December 31, 1985

PHOSPHATE ROCK
(Data in thousand metric tons, unless noted)

1. Domestic Production and Use: Marketable phosphate rock was produced by 20 companies, and the estimated value was $1.2 billion. Twelve companies in Florida and one in North Carolina produced 86% of the phosphate rock. Companies producing phosphate rock in Idaho, Utah, and Montana reported 11% of the total production. Production in Tennessee was about 3% of the total. The principal domestic markets for phosphate rock were fertilizer, 91%; and chemicals manufactured from either elemental phosphorus or refined wet process phosphoric acid, 9%. About 22% of the phosphate rock produced was exported and about 50% was processed into chemicals and fertilizer for export. The major byproducts were fluosilicic acid, vanadium, and uranium.

2. Salient Statistics--United States:

	1981	1982	1983	1984	1985 e/
Production, marketable	53,624	37,414	42,573	49,197	51,000
Sold or used by producers	45,526	38,571	46,839	53,277	48,000
Imports for consumption	13	31	9	9	10
Exports	10,395	9,842	12,010	11,528	11,000
Consumption 1/	35,144	28,760	34,838	41,758	37,010
Price, average value, dollars per ton, f.o.b. mine 2/	26.63	25.50	23.97	23.99	23.50
Stocks, producer, yearend	19,619	18,287	14,500	11,897	14,000
Employment, mine and beneficiation plant	10,000	8,000	7,500	6,500	5,500
Net import reliance 3/ as a percent of apparent consumption	Net exporter				

3. Recycling: None.

4. Import Sources (1981-84): Mexico 60%, Netherlands Antilles 40%.

5. Tariff:

Item	Number	Most Favored Nation 1/1/86	Most Favored Nation 1/1/87	Non-MFN 1/1/86
Phosphates, crude and apatite	480.4500	Free	Free	Free

6. Depletion Allowance: 14% (Domestic) 14% (Foreign).

7. Government Stockpile: None.

8. Events, Trends, and Issues: U.S. agribusiness was at lowered levels as a result of the 1983 payment-in-kind program. Although farm prices showed temporary relief, agribusiness declined. Export markets for U.S. farm products declined in 1984 from increased foreign competition and from increased productivity from other areas in the world. U.S. farmers debt load increased in 1983 and farm land prices, the collateral for financing seed, fertilizer, and machinery, declined. From a 1983 base, demand for phosphate rock is expected to increase at an average annual rate of about 1.8% through 1990. It is estimated that in 1986, domestic production of marketable phosphate rock will be 52 million tons and U.S. consumption will be 38 million tons. Production and consumption could be considerably less than forecast by changing production plans and long range demand growth rates if agribusiness profit margins do not improve. The U.S. phosphate industry has become increasingly dependent on export markets, shipping about 82% of phosphate rock production in 1984 as phosphate rock, processed phosphates, and phosphate uptake in principal crops into foreign markets.

e/ Estimated.
1/ Defined as sold or used plus imports minus exports.
2/ Marketable phosphate rock, weighted value, all grades, domestic and exports.
3/ Defined as imports - exports + adjustments for Government and industry stock changes.

Prepared by W.P. Stowasser, telephone number (202) 634-1190.

PHOSPHATE ROCK

As 1985 progressed, the U.S. and world phosphate rock industry functioned to produce phosphate fertilizers and created an oversupply that, coupled with rising sulfur prices, reduced or eliminated profit margins on processed phosphates. Unusually low prices established by a competitive international market induced buyers to restock supplies of phosphate fertilizers at prices frequently below production costs. By mid-1985, most eastern U.S. producers temporarily closed or reduced production from mines and plants to reduce financial losses and adjust inventories.

There is an element of uncertainty over the effects of the Government's farm product export subsidy program designed to improve the competitive position of U.S. exporters with subsidized European exporters. The success or failure of the program will change phosphate rock demand. New or replacement phosphate rock mines would not be profitable at today's production economics and low selling prices for downstream products. Further restrictions on sodium tripolyphosphate, the detergent builder, are expected to reduce the demand for thermal phosphorus. As phosphate rock mines and fertilizer plants in other areas of the world become operational, U.S. grain selling companies may find it advantageous to backhaul these commodities for sale and distribution in the United States or to achieve U.S. grain sales, barter for foreign-produced fertilizer.

As mines are depleted or closed for economic reasons in Florida, increased emphasis is being placed on finding a replacement tax base for the mining industry and reclaiming mined out lands. The most promising program appears to be reclamation for produce farming to profitably supply the anticipated surge in population in cities on the Gulf of Mexico.

9. World Mine Production and Reserve Base:

	Production		Reserve Base *
	1984	1985 e/	
United States	49,197	51,000	5,400,000
Israel	3,312	3,500	90,000
Jordan	6,263	7,000	510,000
Morocco	21,245	23,000	20,000,000
Senegal	1,912	2,000	130,000
South Africa, Republic of	2,585	2,700	2,600,000
Togo	2,696	2,700	50,000
Tunisia	5,346	6,000	120,000
Other Market Economy Countries	13,615	14,000	2,970,000
China	11,800	13,000	210,000
U.S.S.R.	31,900	33,000	1,300,000
Other Centrally Planned Economies	700	700	325,000
World Total (may be rounded)	150,571	159,000	34,000,000

10. World Resources: Most of the U.S. and world phosphate rock resources are widely distributed marine phosphorite deposits. Identified and undiscovered resources are estimated to contain billions of tons of contained phosphorus. Identified resources in North and West Africa and in the Middle East are estimated to be several times greater than present reserves. Large phosphate resources have been identified on the continental shelves and on sea mounts in the Atlantic and Pacific Oceans. Work is continuing to identify additional resources in these areas. Phosphate rock contains fluorine as an integral part of the mineral apatite. Uranium and vanadium are present in marine phosphorite deposits and rare earths are present in igneous apatite deposits in quantities that may be profitably recoverable.

11. Substitutes: There are no substitutes for phosphorus in agriculture.

* The criteria for the reserve base were established by a joint Bureau of Mines and U.S. Geological Survey working group. The criteria for classification of phosphate resources are given in Geological Survey Circular 882, Sedimentary Phosphate Resource Classification System of the U.S. Bureau of Mines and the U.S. Geological Survey.

Credit No. 6951

Exhibit C

ECONOMIC IMPACT:

Morocco has the world's largest reserves (67 percent of the world's total), is the third largest producer (behind the United States and the U.S.S.R.) and is one of the two largest exporters (along with the U.S.). As Morocco develops its reserves, its exporting role will expand. It is possible that competition with U.S. producers in third country markets will increase over the next twenty years. It is this possible displacement of U.S. exports that creates a possibility of an adverse impact.

In order to assess the extent of the potential adverse impact, two issues must be clarified. The first is the extent of actual Moroccan - U.S. competition in third country markets. In 1978, Morocco sent the vast majority -- nearly 80 percent -- of its phosphate exports to Europe, Asia, Latin America and the United States, itself, were smaller markets. There is no reason to expect this pattern to change in the future. Europe is also the major U.S. export market, accounting for approximately 40 percent of total U.S. exports. Unlike Morocco, however, U.S. producers have also established major markets in Asia and Canada. Based on the Department of Agriculture and Interior forecasts of steadily growing phosphate demand at 5 percent a year, it appears likely that the world market will be able to absorb the growing Moroccan exports without displacing U.S. exports.

The second issue is the nature of U.S. industry. As a recent GAO report, Phosphates: A Case Study of a Valuable, Depleting Mineral in America, points out, U.S. reserves of high-grade phosphates are becoming depleted. It is a generally accepted forecast that U.S. production will peak around 1985 and then gradually decline as the profitable reserves are mined. The key point is that as demand grows and production declines, the U.S. export role will also decline. This is due to the fact that exports, while 25 to 30 percent of current U.S. production, are still largely a residual market. U.S. phosphate production is aimed at domestic agricultural or chemical buyers with excess production being exported. While this is a simplified characterization of the industry, the fact is that as production declines after 1985, it will be reflected directly in the level of export sales.

The combination of these two issues encourages Eximbank support of the Moroccan phosphate expansion. In the short term, the expanded Moroccan sales may compete to some extent with U.S. exports in third country markets. However, given the growing demand, it is unlikely that U.S. sales will be displaced to any significant extent. In the long term, development of the Moroccan resources is in the best interest of the U.S. With U.S. production declining, the existence of a healthy phosphate industry in Morocco is essential to insure the continued supply of a critically important agricultural chemical.

The proposed transaction will have a positive effect on the U.S. economy from the standpoint of employment and balance of trade. Furthermore, the transaction would increase U.S. exporters' negligible share of the Moroccan market in an expanding industry, and it would also provide follow-on business for mining equipment and replacement parts.

In conclusion, no significant adverse impact on the U.S. domestic economy is perceived, and no objection is seen to consideration of this transaction solely on its financial and economic merits.

Credit No. 6780

ECONOMIC IMPACT :

Morocco has the world's largest reserves (67 percent of the world's total), is the third largest producer (behind the United States and U.S.S.R.) and is one of the two largest exporters (along with the U.S.). As Morocco develops its reserves, its exporting role will expand. It is possible that competition with U.S. producers in third country markets will increase over the next twenty years. It is this possible displacement of U.S. exports that creates a possibility of an adverse impact.

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The proposed transaction will have a positive effect on the U.S. economy from the standpoint of employment as it would sustain approximately 191,000 man-hours of labor at the suppliers' plants and those of their subcontractors. Furthermore, the transaction would increase U.S. exporters' neglible share of the Moroccan market in an expanding industry, and it would also provide follow-on business for mining equipment replacement parts.

In conclusion, Policy Analysis finds no significant adverse impact and recommends that this transaction be judged solely on its financial and economic merits.

Credit No. 7048

ONOMIC
MPACT:

Morocco has the world's largest reserves (67 percent of the world's total), is the third largest producer (behind the United States and the USSR) and is one of the two largest exporters (along with the U.S.). As Morocco develops its reserves, its exporting role will expand. It is possible that competition with U.S. producers in third country markets will increase over the next twenty years. It is this possible displacement of U.S. exports that creates a possibility of an adverse impact.

In order to assess the extent of the potential adverse impact, two issues must be clarified. The first is the extent of actual Moroccan-U.S. competition in third country markets. In 1978, Morocco sent the vast majority - nearly 80 percent -- of its phosphate exports to Europe. Asia, Latin America and the United States, itself, were smaller markets. There is no reason to expect this pattern to change in the future. Europe is also the major U.S. export market, accounting for approximately 40 percent of total U.S. exports. Unlike Morocco, however, U.S. producers have also established major markets in Asia and Canada. Based on the Department of Agriculture and Interior forecasts of steadily growing phosphate demand at 5 percent a year, it appears likely that the world market will be able to absorb the growing Moroccan exports without displacing U.S. exports.

The second issue is the nature of U.S. industry. As a recent GAO report, Phosphates: A Case Study of a Valuable, Depleting Mineral in America, points out, U.S. reserves of high-grade phosphates are becoming depleted. It is a generally accepted forecast that U.S. production will peak around 1985 and then gradually decline as the profitable reserves are mined. The key point is that as demand grows and production declines, the U.S. export role will also decline. This is due to the fact that exports, while 25 to 30 percent of current U.S. production, are still largely a residual market. U.S. phosphate production is aimed at domestic agricultural or chemical buyers, with excess production being exported. While this is a simplified characterization of the industry, the fact is that as production declines after 1985, it will be reflected directly in the level of export sales.

The combination of these two issues encourages Eximbank support of the Moroccan phosphate expansion. In the short term, the expanded Moroccan sales may compete to some extent with U.S. exports in third country markets. However, given the growing demand, it is unlikely that U.S. sales will be displaced to any significant extent. In the long term, development of the Moroccan resources is in the best interests of the U.S. With U.S. production declining, the existence of a healthy phosphate industry in Morocco is essential to insure the continued supply of a critically important agricultural chemical.

The proposed facility will have a positive effect on the U.S. economy from the standpoint of employment and balance of trade. Furthermore, the facility would increase U.S. exporters' negligible share of the Moroccan market in an expanding industry, and it would also provide follow-on business for mining equipment and replacement parts.

In conclusion, no significant adverse impact on the U.S. domestic economy is perceived, and no objection is seen to consideration of this facility solely on its financial and economic merits.